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CHAPTER 2
STATE AND LOCAL GOVERNMENT ACCOUNTING AND FINANCIAL REPORTING MODEL: THE FOUNDATION

ANSWERS TO QUESTIONS

Question 2-1

Governments operate in a different environment than businesses. Governments must comply with the many ***finance-related legal and contractual requirements***, ***regulations, restrictions, and agreements*** that affect their financial management and accounting. Such compliance must be demonstrable and be reported regularly. Governments should also prepare financial statements in conformity with generally accepted accounting principles (GAAP), which provide uniform minimum national standards of and guidelines for annual financial reporting to groups and persons outside the government. Therefore, one fundamental feature of a government's accounting system is that it must maintain and provide information that accomplishes multiple purposes.

Whereas business accounting systems must provide data both for GAAP reporting and for income tax reporting, governmental accounting systems must provide data both for external reporting in conformity with GAAP and for controlling and reporting on finance-related legal compliance matters. This necessitates having different accounting systems for businesses and governments.

Question 2-2

The measurement focus for the three fund categories are:

1. ***Proprietary Funds***—economic resources (revenues and expenses) measurement focus, which is the measurement focus used by business enterprises.

2. ***Governmental Funds***—the current financial resources measurement focus.

3. ***Fiduciary Funds***—the same measurement focus as proprietary funds—the economic resources measurement focus.

An **economic resources** measurement focus results in accounting for *all* assets—both *current* and *noncurrent*—and *all* liabilities—both *current* and *long-term*. A **current financial resources** measurement focus results in accounting for financial assets and related liabilities. Noncurrent assets and long-term liabilities are not reported under a current financial resources measurement focus.

The GASB's approach to each measurement focus also includes two financial statement elements not found in accounting for other types of entities—deferred outflows of resources and deferred inflows of resources. These elements arise from changes in net assets that the GASB has determined should not be reflected as changes in fund balance (governmental funds) or net position (proprietary funds and fiduciary funds) until a future period.

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Question 2-3

For governmental funds:

1. Revenues must be (1) "*available*"—collectible within the period or soon enough thereafter to be used to pay for the expenditure liabilities incurred during the period, as well as levied or earned—*and* (2) *measurable* to be recognized.

2. Expenditures are financial assets expended during a period for current operations, capital outlay, and debt service including (a) long-term debt principal retirement and (b) interest on both short-term and long-term indebtedness.

For proprietary funds:

1. Revenues are recognized when earned and measurable. There is no "availability" criterion for revenues recognized in proprietary funds.

2. Expenses are costs consumed or expired during a period.

Difficulty: 1
Learning Objective: 2
AACSB: Reflective thinking

Question 2-4

General capital assets are not considered appropriable resources and unmatured general long-term liabilities are not current liabilities. Hence, these assets and liabilities would not appropriately be accounted for within a municipality's governmental (expendable) funds, which are net current financial resource entities. Further, general capital assets are considered to belong to the government as a whole, not to a particular department or enterprise; and unmatured general long-term liabilities are likewise considered obligations of the government, not of a specific fund. Thus, neither fits into the existing fund structure of state and local governmental accounting, and both are accounted for through the General Capital Assets and General Long-Term Liabilities nonfund accounts. They are reported only in the government-wide financial statements.

Question 2-5

Capital assets and long-term liabilities are accounted for in:

General Capital Assets and General Long-Term Liabilities accounts
Enterprise Funds
Internal Service Funds
Trust Funds (some)

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Question 2-5 (continued)
General capital assets and general long-term liabilities are accounted for in the General Capital Assets and General Long-Term Liabilities accounts. They are related to general government (governmental) activities.

Question 2-6

A Special Revenue Fund should be used to account for and report the proceeds of specific *revenue sources* that are restricted or committed to expenditure for specified general government purposes other than debt service or capital projects.

A Capital Projects Fund should be used to account for and report financial resources that are restricted, committed, or assigned to expenditure for general government capital outlays, including the acquisition or construction of capital facilities and other capital assets.

A Debt Service Fund should be used to account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest on general long-term liabilities.

Question 2-7

Proprietary funds include Enterprise Funds and Internal Service Funds. Proprietary fund financial statements include a balance sheet (statement of net position), statement of revenues, expenses, and changes in fund net position, and statement of cash flows.

Question 2-8

Governmental funds include the General Fund, Special Revenue Funds, Capital Projects Funds, Debt Service Funds, and Permanent Funds. Governmental fund financial statements include a balance sheet, statement of revenues, expenditures, and changes in fund balance (GAAP basis), and statement of revenues, expenditures, and changes in fund balance - budget and actual (on the budgetary basis of accounting).

Question 2-9

Fiduciary funds include Private-Purpose Trust Funds, Investment Trust Funds, Pension Trust Funds, and Agency Funds. Trust fund financial statements include a statement of net position and a statement of changes in fiduciary net position. Agency Fund financial statements include a statement of net position and a statement of changes in agency fund assets and liabilities. (The latter is required in a comprehensive annual financial report but not in the basic financial statements).

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Question 2-10

One only: General Fund and General Capital Assets and General Long-Term Liabilities accounts

One, none, or many—all other fund types:

Special Revenue Funds	Internal Service Funds	Private-Purpose Trust Funds
Capital Projects Funds	Enterprise Funds	Investment Trust Funds
Debt Service Funds		Pension Trust Funds
Permanent Funds		Agency Funds

Question 2-11

Interfund loans are amounts provided by one fund to another ***with*** a ***requirement*** **for and expectation of** ***repayment***. Interfund loans are the only type of interfund transaction that initially affects only balance sheet accounts. Because interfund loans are expected to be repaid, a loan is reported as a receivable (asset) in the lending fund and as a payable (liability) in the debtor fund. Neither fund balance nor net position of any fund changes because of an interfund loan—whether it is a short-term loan or a long-term loan.

Interfund transfers are flows of assets (such as cash or goods) from one fund to another ***without equivalent flows of assets or services in return*** *and* ***without*** a ***requirement for repayment***.

- In ***governmental*** funds, transfers should be reported as ***other [nonexpenditure] financing uses*** in the funds making transfers and as ***other [nonrevenue] financing sources*** in the funds receiving transfers.
- In ***proprietary*** funds, transfers should be reported as the last item before the subtotal for changes in net position.

Question 2-12

The Basic Financial Statements, which must be accompanied by Management's Discussion and Analysis and certain other required supplementary information, include the government-wide financial statements (Statement of Net Position and Statement of Activities), the three sets of fund financial statements (governmental funds financial statements, proprietary funds financial statements, and fiduciary funds financial statements), and the related notes. The Comprehensive Annual Financial Report (CAFR) of a governmental unit includes the basic financial statements and is much more extensive. A CAFR contains:

1. Introductory materials e.g., letter(s) of transmittal,
2. Management's Discussion and Analysis,
3. Basic Financial Statements and notes as well other required supplementary information,

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Question 2-12 (continued)

4. Combining financial statements (for nonmajor governmental funds, nonmajor Enterprise Funds, Internal Service Funds, Trust Funds, and Agency Funds—if there are two or more funds in these categories. These are a minimum. Other combining statements may be presented.),
5. Individual fund financial statements and schedules (where appropriate),
6. Narrative explanations (notes for combining or individual fund financial statements), and
7. Statistical section.

Items 2 through 6, including the auditor's report, are called the financial section of a CAFR.

Question 2-13

Government-wide financial statements are prepared using the same measurement focus and basis of accounting that is used for proprietary funds—the ***economic resources*** measurement focus and the ***accrual*** basis of accounting.

Question 2-14

The accounting equation for a governmental fund is:

(Financial Assets + Deferred Outflows) – (Related Liabilities + Deferred Inflows) = Fund Balance

Question 2-15

The accounting equation for a proprietary fund is:

Assets + Deferred Outflows − Liabilities − Deferred Inflows = Net Position

Question 2-16

Deferred outflows and deferred inflows result from delaying operating statement recognition of certain changes in the net amount of assets less liabilities. The GASB requires these changes to be classified as deferred outflows instead of assets (or as deferred inflows instead of liabilities) when the GASB views the change as related to future periods. (Some recent deferred outflows and deferred inflows—e.g., proprietary fund and government-wide deferred outflows and deferred inflow related to pensions and other postemployment benefits—appear to result more from smoothing of the expense measurement than from being related to future periods.)

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Question 2-16 (continued)
Deferred outflows are reported similarly to assets, and changes in deferred outflows affect the operating statement in essentially the same way as changes in assets. Likewise, deferred inflows are reported similarly to liabilities, and changes in deferred inflows affect the operating statement in essentially the same manner as changes in liabilities.

Question 2-17

The primary characteristic that distinguishes Enterprise Funds from Internal Service Funds is who the "customers" are. Enterprise Funds serve primarily individuals and organizations separate from the government. Internal Service Funds serve predominantly other departments and agencies of the government itself.

The primary distinction of a Special Revenue Fund compared to the General Fund is that a Special Revenue Fund's resources are to be used for a specified purpose(s), whereas most General Fund resources are available for any legitimate need of the government. A Special Revenue Fund is required to have a revenue source that is either restricted or committed to the specified purposes of the fund as opposed to only resources provided to that fund at the discretion of the government. The other governmental funds are not required to have such a revenue source to serve as the foundation of the fund.

Question 2-18

The General Fund is always a major fund. In addition, any other governmental fund or Enterprise Fund that meets both of the following "size" criteria must be reported as a major fund. The quantitative major fund criteria are:

1. Total assets, liabilities, revenues, or expenditures/expenses (excluding extraordinary items) of that individual governmental fund or Enterprise Fund are at least 10% of the corresponding total (assets, liabilities, revenues, or expenditures/expenses) for all funds of that category or type (i.e., total governmental funds or total Enterprise Funds).

2. The same element that met the 10% criterion in (a) is at least 5% of the corresponding element total for all governmental funds and Enterprise Funds combined.

A governmental fund or Enterprise Fund that does not meet the size criteria may still be treated as a major fund if the government deems it of sufficient importance to statement users. Thus, a government must identify as a major fund each governmental fund or Enterprise Fund for which statement users are likely to need individual fund information.

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SOLUTIONS TO EXERCISES

Exercise 2-1

1. a
2. b
3. d
4. a
5. b
6. d
7. c
8. d
9. a
10. d

Exercise 2-2

1. b
2. c
3. a
4. d
5. b
6. c
7. c
8. c
9. a
10. c

Exercise 2-3

1. Special Revenue Fund
2. Capital Projects Fund
3. Enterprise Fund
4. General Fund
5. General Capital Assets and General Long-Term Liabilities nonfund accounts
6. General Capital Assets and General Long-Term Liabilities nonfund accounts
7. General Capital Assets and General Long-Term Liabilities nonfund accounts*
8. Debt Service Fund
9. Enterprise Fund
10. Internal Service Fund

*General long-term liabilities do not become governmental fund liabilities until the period in which they mature.

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Exercise 2-4

a. Special Revenue
b. Debt Service
c. Capital Projects
d. Special Revenue
e. Internal Service
f. Enterprise, if criteria met; otherwise Special Revenue if the revenues are restricted or committed, or General Fund if the revenues are not restricted or committed
g. Agency
h. General
i. Enterprise
j. Capital Projects
k. Debt Service
l. Permanent
m. Capital Projects
n. Pension Trust

Exercise 2-5

a, b, c, and d

Exercise 2-6

Name of Government
Governmental Fund
Statement of Revenues, Expenditures, and Changes in Fund Balances
Time Period Report Covers

Revenues (by source)	c
Expenditures (by function)	d, e, f, g, h
Excess (Deficiency) of Revenues Over (Under) Expenditures	
Other Financing Sources (Uses)	a, (b)
Special and Extraordinary Items*	j
Net Change in Fund Balance	
Fund Balance (Total), Beginning	
Fund Balance (Total), Ending	

*The amounts reported for special items and extraordinary items would be proceeds received or expenditures incurred for those items, not gains and losses.
Note: Depreciation expense (i) is not recorded in this statement.

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Exercise 2-7

Name of Government
Proprietary Fund
Statement of Revenues, Expenses, and Changes in Net Position
Time Period Report Covers

Operating revenues (by source)	c
Total operating revenues	
Operating expenses (detailed)	d, i
Total operating expenses	
Operating income	
Nonoperating revenues and expenses (detailed)	h, k
Income before capital contributions, special and extraordinary items, and transfers	
Capital contributions	
Special and extraordinary items (detailed)	e, j
Transfers	b
Increase (decrease) in net position	
Net position—beginning of period	
Net position—end of period	

Note: Proceeds from issuing bonds (a), Expenditures for purchases of equipment (f), and Expenditures for principal retirement of long-term liabilities (g) are not reported in this statement.

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Exercise 2-8

Name of Government
Governmental Fund
Balance Sheet
Fiscal Year End

Assets	**a, d, g**
Liabilities, and fund balance	
Liabilities	j
Fund balance	c, i
Total liabilities and fund balance	

Note: Unrestricted net position (b), Land (e), Bonds payable (f), Current portion of bonds payable (h), and Buildings and equipment (k) are not reported in this statement.

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Exercise 2-9

Name of Government
Proprietary Fund
Statement of Net Position
Fiscal Year End

Assets	
Current Assets:	a, d, g
Noncurrent Assets:	
Capital Assets	e, k
Total Assets	
Liabilities	
Current liabilities	h, j
Noncurrent liabilities	f
Total liabilities	
Net Position	**b**
Total net position	

Note: Nonspendable fund balance (c) and Unassigned fund balance (i) are not reported in this statement.

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Exercise 2-10

(1) Proprietary fund

Analysis of Transactions for Business-Type Activities

	Proprietary Funds								
	CA	**+**	**NCA**	**–**	**CL**	**–**	**LTL**	**=**	**NP**
a.	($5,100)				$200				($5,300)
b.	3,000								3,000
c1.	2,000				2,000				
c2.					150				(150)
d.	(2,200)				(2,150)				(50)
e.	200								$200
f.	1,000						$1,000		
g.	(100)								(100)
h.	(800)						(800)		
i.	(900)		$900						
j.			(280)						(280)
k.	35		(60)						(25)

*Calculations for:

c2. Interest accrual at year end, $2,000 x .10 x 9/12 = $150

d. Liability reduction equals principal of $2000 plus accrued interest payable of $150.

k. Capital asset carrying value at disposal equals $60 (cost of $900 less accumulated depreciation after three years of $840). Proprietary fund loss on sale of the capital asset is $35 (proceeds) less $60 (carrying value) or $25.

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Exercise 2-10 (continued)

(2) Governmental fund and nonfund accounts

Analysis of Transactions for General Government Activities

	Governmental Funds					General Capital Assets and General Long-Term Liabilities Nonfund Accounts				
	FA	–	**RL**	=	**FB**	**GCA**	–	**GLTL**	=	**NP**
a.	($5,100)		$200		($5,300)					
b.	3,000				3,000					
c1	2,000		2,000							
c2.			150		(150)					
d.	(2,200)		(2,150)		(50)					
e.	200				200					
f.	1,000				1,000			$1,000		($1,000)
g.	(100)				(100)					
h.	(800)				(800)			(800)		800
i.	(900)				(900)	$900				900
j.						(280)				(280)
k.	35				35	(60)				(60)

Legend

Proprietary Funds		Governmental Fund; General Capital Assets and General Long-Term Liabilities Nonfund Accounts	
CA	Current Assets	**FA**	Financial Assets
CL	Current Liabilities	**RL**	Related Liabilities
LTL	Long-Term Liabilities	**FB**	Fund Balance
NP	Net Position	**GCA**	General Capital Assets
NCA	Noncurrent Assets (including capital assets)	**GLTL**	General Long-Term Liabilities
		NP	Net Position

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SOLUTIONS TO PROBLEMS

Problem 2-1 (a)

Analysis of Transactions for General Government Activities

		Governmental Funds					General Capital Assets and General Long-Term Liabilities Nonfund Accounts				
	Fund	**FA**	**–**	**RL**	**=**	**FB**	**GCA**	**–**	**GLTL**	**=**	**NP**
E.	*GF*	*8,000*				*8,000*					
1.	GF			$75,000		($75,000)					
2.	CPF	$9,000,000				9,000,000			$9,000,000		($9,000,000)
3.	CPF	(5,000,000)				(5,000,000)	$5,000,000				5,000,000
4.	GF			60,000		(60,000)	60,000				60,000
4*	GF			1,200**		(1,200)					
5.	GF	(8,000,000)				(8,000,000)					
6.									3,000,000		(3,000,000)
7.	DSF	(11,000,000)				(11,000,000)			(10,000,000)		10,000,000
8.	GF	1,500				1,500	(1,000)				(1,000)

*Year-end entry.

**Accrue interest on short-term debt ($60,000 × .06 × 4/12).

Legend

FA	Financial Assets	**GF**	General Fund
RL	Related Liabilities	**CPF**	Capital Projects Fund
FB	Fund Balance	**DSF**	Debt Service Fund
GCA	General Capital Assets	**GLTL**	General Long-Term Liabilities
NP	Net Position		

Analysis of Transactions for Business-Type Activities

	Airport Enterprise Fund								
	CA	**+**	**NCA**	**–**	**CL**	**–**	**LTL**	**=**	**NP**
5.	$8,000,000								$8,000,000

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Problem 2-1 (b)

1. Expenditures of $75,000 reported in General Fund.
2. Other Financing Sources—Bond Issuance of $9,000,000 reported in Capital Projects Fund.
3. Expenditures of $5,000,000 reported in Capital Projects Fund.
4. Expenditures of $60,000 reported in General Fund.
   At year end, expenditures of $1,200 interest reported in General Fund.
5. Other Financing Uses (Transfer to Other Fund) of $8,000,000 reported in General Fund.
   Transfers from Other Fund of $8,000,000 reported in Airport Enterprise Fund.
6. No operating statements are prepared for GCA-GLTL accounts.
7. Expenditures of $11,000,000 reported in Debt Service Fund.
8. Other Financing Sources of $1,500 reported in General Fund.

Enterprise Fund Legend

CA	Current Assets
CL	Current Liabilities
LTL	Long-Term Liabilities
NP	Net Position
NCA	Noncurrent Assets (including capital assets)

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Problem 2-2 (a)

Governmental Funds

	Fund	Financial Assets	–	Related Liabilities	=	Fund Balance
1.	GF	($500,000)				($500,000)
2.	SRF	(38,000)				(38,000)
4a.	GF	50,000		50,000		
4b.*	GF			2,500		(2,500)
5.	CPF	15,000,000				15,000,000
6.	CPF	(185,000)				(185,000)
7.	CPF	(14,715,000)				(14,715,000)
8a.**	CPF	(100,000)				(100,000)
8b.	DSF	100,000				100,000
9a.	GF	(1,500,000)				(1,500,000)
9b.	DSF	1,500,000				1,500,000
10.***	DSF	(1,200,000)				(1,200,000)
11.****	GF	(53,750)		(52,500)		(1,250)
13.	GF	(100,000)		10,000		(110,000)
14.	GF	4,000				4,000
15.	DSF	(110,000)				(110,000)

* Accrue interest on short-term debt ($50,000 × .10 × 6/12).

** $15,000,000 − $185,000 − $14,715,000

*** $15,000,000 × .08 × 1

**** Balance of interest owed ($50,000 × .10 × 3/12 = $1,250).

General Capital Assets (GCA) and General Long-Term Liabilities (GLTL) nonfund accounts

	GCA	−	GLTL	=	Net Position
2.	$38,000				$38,000
5.			15,000,000		(15,000,000)
6.	185,000				185,000
7.	14,715,000				14,715,000
14.*	(9,000)				(9,000)
15.			(100,000)		100,000

* $15,000 less accumulated depreciation of ($15,000 − $7,000) × 3/4

Proprietary Funds

	Fund	Current Assets (CA)	+	Non-CA	−	Current Liabilities	−	Long-Term Liabilities	=	Net Position
3a.	EF	$5,000,000						$5,000,000		
3b.*	EF					$75,000				($75,000)
12.	EF	1,000,000								1,000,000
13.	EF	110,000								110,000

* Accrue interest at year end ($5,000,000 × .06 × 3/12).

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Problem 2-2 (b)

REPORTING in the Statement of Revenues, Expenditures, and Changes in Fund Balance of the:

1. GF—Expenditures, $500,000
2. SRF—Expenditures, $38,000
4b. GF—Expenditures, $2,500
5. CPF—Other financing sources—Bonds $15,000,000
6. CPF—Expenditures, $185,000
7. CPF—Expenditures, $14,715,000
8a. CPF—Other financing uses—Transfer to other funds, $100,000
8b. DSF—Other financing sources—Transfer from other funds, $100,000
9a. GF—Other financing uses—Transfer to other funds, $1,500,000
9b. DSF—Other financing sources—Transfer from other funds, $1,500,000
10. DSF—Expenditures, $1,200,000
11. GF—Expenditures, $1,250
13. GF—Expenditures, $110,000
14. GF—Other financing sources of $4,000
15. DSF—Expenditures, $110,000

REPORTING in the Statement of Revenues, Expenses, and Changes in Fund Net Position

3b. Nonoperating expense (Interest expense), $75,000
12. Operating revenues, $1,000,000
13. Operating revenues, $110,000

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Problem 2-3 (1)

Governmental Funds

	Fund	Financial Assets	−	Related Liabilities	=	Fund Balance
1.	CPF	$4,000,000				$4,000,000
2.	CPF	(2,200,000)		600,000		(2,800,000)
3a.	GF	(120,000)				(120,000)
3b.	DSF	120,000				120,000
4.	GF	(315,000)				(315,000)

General Capital Assets (GCA) and General Long-Term Liabilities (GLTL) nonfund accounts

	GCA	−	GLTL	=	Net Position
1.			$4,000,000		($4,000,000)
2.	$2,800,000				2,800,000
4.			(300,000)		300,000

Proprietary Funds

	Fund	Current Assets (CA)	+	Non-CA	−	Current Liabilities	−	Long-Term Liabilities	=	Net Position
5a.	EF	$14,000,000						$14,000,000		
5b.*	EF					$210,000				($210,000)

*** Accrue interest at year end ($14,000,000 × .06 × 3/12).**

Problem 2-3 (2)

REPORTING in the Statement of Revenues, Expenditures, and Changes in Fund Balance of the:

1. CPF—Other financing sources—Bonds, $4,000,000
2. CPF—Expenditures, $2,800,000

3a. GF—Other financing uses—Transfer to other funds, $120,000
3b. DSF—Other financing sources—Transfer from other funds, $120,000
4. GF—Expenditures, $315,000

REPORTING in the Statement of Revenues, Expenses, and Changes in Fund Net Position

5b. Nonoperating expense (Interest expense), $210,000

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Problem 2-4 (a)

Governmental Funds

	Fund	Financial Assets	−	Related Liabilities	=	Fund Balance
1.*	GF	($3,000,000)		($18,000)		($2,982,000)
2.	CPF	10,000,000				10,000,0000
3. **	DSF	(400,000)				(400,000)
4.	CPF	(5,000,000)		346,500		(5,346,500)
5a.***	GF	(1,400,000)				(1,400,000)
5b.	DSF	1,400,000				1,400,000
5c.****	DSF	(1,400,000)				(1,400,000)
6.	GF	(500,000)				(500,000)
7.	GF	1,500,000				1,500,000
8.	GF	15,000				15,000

*Related Liabilities: $50,000 − $32,000 = $18,000 decrease during year.

**While not an accrual, interest will be paid by DSF at mid-year ($10,000,000 × .08 × .5 = $400,000). Although not indicated in the problem, sufficient funds will be transferred from the General Fund to the Debt Service Fund for the payment.

***Interest Paid ($10,000,000 × .08 × 1/2 = $400,000).

****Principal ($1,000,000) + Interest ($400,000).

General Capital Assets (GCA) and General Long-Term Liabilities (GLTL) nonfund accounts

	GCA	−	GLTL	=	Net Position
2.			$10,000,000		($10,000,000)
4.	$5,346,500				5,346,500
5c.			(1,000,000)		1,000,000
6.			7,000,000		(7,000,000)
7. *	(500,000)				(500,000)
8.	(20,000)				(20,000)

*The problem does not state explicitly that the land sold is a general capital asset. If not, there are two possibilities for the accounting for this land. Most likely, the land is accounted for in an enterprise activity, in which case neither the GF nor the GCA are affected. As an EF transaction, the analysis would be CA (+ $1,500,000), NCA (−$500,000), and NA (+$1,000,000). The $1,000,000 increase in net position would be reported in the EF operating statement as a nonoperating gain unless determined to qualify as a special item. Alternatively, the land could have been held for resale by the General Fund (see the discussion of Nonspendable Fund Balance on page 133 of the textbook). In this event, there would have been a corresponding decrease in Financial Assets and Fund Balance in the GF of $500,000. There would have been no impact on GCA in this case.

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Problem 2-4 (b)

REPORTING in the Statement of Revenues, Expenditures, and Changes in Fund Balance of the:

1. GF—Expenditures, $2,982,000
2. CPF—Other financing sources—Bonds, $10,000,000
3. No effect. (There is no accrual. Interest expenditures of $400,000 are reported for interest paid on the semiannual interest payment date.)
4. CPF—Expenditures, $5,346,500

5a. GF—Other financing uses—Transfer to other funds, $1,400,000
5b. DSF—Other financing sources—Transfer from other funds, $1,400,000
5c. DSF—Expenditures, $1,400,000

6. GF—Expenditures, $500,000
7. GF—Other financing sources of $1,500,000 unless it qualifies as a special item
8. GF—Other financing sources of $15,000

Problem 2-5 (a)

Although the statement presented could be modified to present the sources and uses of financial resources of a governmental (expendable) fund such as the General Fund, the operation of this bus line service is a long-term "business-type" undertaking. All assets, liabilities, and equity associated with the bus line should be accounted for through an Enterprise Fund. All expenses (not expenditures)–including depreciation, inventories consumed, and interest–should be reported in order for the operating results of such an activity to be assessed validly.

While the General Fund-based operating statement shown reports a "net profit," an accrual basis statement would reflect different information once depreciation expense, inventory consumption, and interest expense are included.

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Problem 2-5 (b)

Mobiline County Enterprise Fund Bus Line
Statement of Revenues, Expenses, and Changes in Fund Net Position
For the Nine-Month Period Ending October 31, 20X3

Operating Revenues:			
Passenger fares—routine route service		$77,000	
Special charter fees (1)		4,000	
Total Operating Revenues			$81,000
Operating Expenses:			
Salaries (superintendent, drivers, mechanics)		52,000	
Depreciation -			
Buses (2)	$21,000		
Building (3)	6,000		
Shop equipment (4)	1,125	28,125	
Fuel and lubrication		12,000	
Tires and parts (5)		13,000	
Contracted repairs and maintenance		8,000	
Miscellaneous		1,000	
Total Operating Expenses			114,125
Operating Loss			(33,125)
Nonoperating Revenues and Expenses:			
Interest expense (6)			13,500
Decrease in Net Position			(46,625)
Net Position, February 1, 20X3			–
Net Position, October 31, 20X3			$(46,625)

Computations:
(1) $3,000 collected + $1,000 accrued = $4,000
(2) 3/4($140,000/5) = $21,000
(3) 3/4($80,000/10) = $6,000
(4) 3/4($15,000/10) = $1,125
(5) $15,000 acquired 2/1/X3 + $1,000 purchased − $3,000 on hand = $13,000
(6) .06(10 × $30,000) 3/4 = $13,500

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Problem 2-6 (a)

	Cash Basis		Modified Accrual Basis		Accrual Basis	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
1-1 Accounts Receivable			4,000		4,000	
Revenues				4,000		4,000
1-3 Expenditures			500			
Inventory of Supplies					500	
Accounts Payable				500		500
1-5 Expenditures			30,000			
Truck					30,000	
Accounts Payable				30,000		30,000
1-11Cash	2,000		2,000		2,000	
Accounts Receivable				2,000		2,000
Revenues		2,000				
1-15 Expenditures			3,000			
Expenses					3,000	
Wages Payable				3,000		3,000
1-17 Expenditures	500					
Accounts Payable			500		500	
Cash		500		500		500
1-21 Expenditures	3,000					
Wages Payable			3,000		3,000	
Cash		3,000		3,000		3,000
2-3 Expenditures	30,000					
Accounts Payable			30,000		30,000	
Cash		30,000		30,000		30,000
2-5 Expenses					200	
Inventory of Supplies						200
2-6 Depreciation Expense					500	
Accumulated Depreciation						500

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Problem 2-6 (b)

The modified accrual and accrual bases are similar in that accruable revenue is recognized prior to cash receipt. They are also similar in that liabilities are recognized when incurred. However, the accrual basis measures expenses (costs expired) while the modified accrual basis measures expenditures (net financial assets expended for current operations, capital outlay, long-term debt principal retirement, and interest).

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SOLUTION TO CASES

Case 2-1

1. Special Revenue Fund
2. Internal Service Fund
3. Debt Service Fund
4. Enterprise Fund
5. Capital Projects Fund
6. Special Revenue Fund
7. Capital Projects Fund
8. Internal Service Fund
9. Agency Fund
10. Internal Service Fund
11. Enterprise Fund
12. Pension Trust Fund
13. Special Revenue Fund

Students' discussion and questions may demonstrate that they have made good progress on mastering the fund structure even when an answer is incorrect. For instance, a student who notes that item 10 does not explicitly state the charges are intended to reimburse the costs of services provided might give a response other than an Internal Service Fund. Raising this point reflects that the student has learned the Internal Service Fund definition. However, the fact that it is named a revolving fund suggests the "capital maintenance" notion, which is a primary consequence of cost-reimbursement based charges.

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Case 2-2 (a)

Governmental Funds

	Fund	Financial Assets	-	Related Liabilities	-	Deferred Inflows of Resources	=	Fund Balance
1.	GF	($67,000,000)		$1,240,000				($68,240,000)
2.*	GF	133,110,000				2,610,000		130,500,000
3.	CPF	121,750,000						121,750,000
4.	CPF	(68,818,000)		12,400,000				(81,218,000)
5.	GF	(17,600,000)						(17,600,000)
6a.**	SRF	(690,000)						(690,000)
6b.***	SRF	690,000						690,000
7a.	GF	(6,077,000)						(6,077,000)
7b.	DSF	6,077,000						6,077,000
8.	DSF	(7,400,000)						(7,400,000)

* Financial Assets: Taxes Receivable ($135,000,000) less Allowance for Uncollectible Taxes ($1,890,000)

Revenues: Financial Assets ($133,110,000) less Deferred Inflows ($2,610,000)

** To record expenditures by school district for deaf and hearing-impaired program.

*** To record grant proceeds from federal government.

General Capital Assets (GCA) and General Long-Term Liabilities (GLTL) nonfund accounts

	GCA	-	GLTL	=	Net Position
3.			$121,750,000		($121,750,000)
4.	$81,218,000				81,218,000
8.			(1,400,000)		1,400,000

Case 2-2 (b)

REPORTING in the Statement of Revenues, Expenditures, and Changes in Fund Balance of the:

1. GF—Expenditures, $68,240,000
2. GF—Revenues, $130,500,000
3. CPF—Other financing sources—Bonds, $121,750,000
4. GF—Expenditures, $81,218,000
5. GF—Expenditures, $17,600,000

6a. SRF—Expenditures, $690,000

6b. SRF—Revenues, $690,000

7a. GF—Other financing uses—Transfer to DSF, $6,077,000

7b. DSF—Other financing sources—Transfer from GF, $6,077,000

8. DSF—Expenditures, $7,400,000

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CHAPTER TWO

STATE AND LOCAL GOVERNMENT ACCOUNTING AND FINANCIAL REPORTING MODEL: THE FOUNDATION
(Pages 31–68)

CHAPTER TWO OUTLINE

1) Overview of the GASB financial reporting model

2) The fundamental features of the SLG accounting and financial reporting model
   a) GAAP and legal compliance
      i) GAAP reporting
      ii) Compliance
   b) Fund accounting
   c) Fund categories
      i) Proprietary funds
      ii) Governmental funds
      iii) Deferred outflows of resources and deferred inflows of resources—discussion approach
      iv) Nonfund accounts
      v) Fiduciary funds
   d) Transaction analysis
   e) Types of funds
      i) Types of proprietary funds
      ii) Types of governmental funds
      iii) Identifying governmental fund types in transaction analysis
      iv) Types of fiduciary funds
      v) Summary of types of funds
   f) Comparative financial statement formats
      i) Operating statements
      ii) Balance sheets
   g) Annual financial reporting
      i) Individual and combining statements
      ii) Financial reporting entity and component units
      iii) Government-wide financial statements

3) Concluding comments

4) Questions

5) Exercises

6) Problems

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7) Cases

CHAPTER LEARNING OBJECTIVES

2-1 Visualize, summarize, and discuss the major overall aspects of the GASB state and local government financial reporting model, including the dual perspective of government-wide and fund financial statements.

2-2 Explain the fundamental features of the state and local government accounting and financial reporting model, including:

- Distinguishing the three broad categories of funds—governmental, proprietary, and fiduciary—and the specific types of funds in each fund category.
- Identifying and explaining the measurement focus and basis of accounting used for each category of funds and the financial statements required for funds of each category.
- Analyzing the effects of transactions on the proprietary fund and governmental fund categories and on the General Capital Assets and General Long-Term Liabilities accounts.
- Identifying typical budgetary accounting and reporting requirements.
- Explaining the financial reporting requirements for a Government's basic financial statements and its comprehensive annual financial report.

CHAPTER OVERVIEW AND SYNOPSIS

Chapter 2 is a critical chapter. Some consider it the most important in the text for optimizing student success and understanding. The chapter covers the whole breadth of government financial reporting at an introductory level on most topics. The learning objectives for this chapter are voluminous. Certain objectives in this chapter are essential to student understanding of subsequent chapters, while others are not, and will be met more fully in later chapters.

Chapter 2 includes:

- An extensive overview and introduction to the GASB Financial Reporting Model. In this context, the chapter reviews the most significant characteristics of the SLG environment and the resultant SLG financial reporting objectives established by the GASB.

- Extensive discussions and illustrations of the fundamental features of the SLG accounting and financial reporting model. It contains an extensive discussion of the basic features of fund accounting, including identifying and understanding fund categories and fund types. Also, the chapter introduces the two newest elements of the financial statements—deferred outflows of resources and deferred inflows of resources.

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- An introduction to the measurement focus and basis of accounting used in the different fund categories.

- Numerous illustrations designed to enhance a student's understanding of the unique SLG accounting and financial reporting environment.

As was the case in Chapter 1, many of the topics and concepts *introduced* in this chapter will be reviewed in *much greater detail* in subsequent chapters. For example, Chapters 3 through 15 in the text address in detail the broad concepts introduced within Chapter 2, as follows:

• Chapter 3	Budgeting
• Chapters 4 and 7–12	Fund Accounting
• Chapters 4–6 and 10–12	Measurement Focus/Basis of Accounting
• Chapters 13, 14, and 15	Financial Reporting

CRITICAL OBJECTIVES

The primary learning objectives for this chapter include:

- Developing an understanding of the focus of the government financial reporting model. Emphasis should be placed on the *fundamental* differences between the government-wide and the fund financial statements (within the context of framing the model for further discussion in later chapters).
- Understanding the nature and differences of governmental funds and proprietary funds. (Illustration 2-10 on page 51 is an excellent resource for this discussion.) Fiduciary funds are important as well, but focusing student attention at this early stage on the two primary fund categories that they will use most often typically proves beneficial from a learning standpoint. You want students to understand the governmental fund model and the proprietary fund model. This understanding should include the accounting equation for each of these categories of funds, the required financial statements, and the measurement focus and basis of accounting. Again, Illustration 2-10 should be very useful in this regard. (Illustrations 2-6 and 2-7 are designed to assist students in comparing and contrasting the governmental and proprietary reporting models in a very practical way.)
- Understanding the nonfund accounting entity used to account for general capital assets and general long-term liabilities.
- Understanding the definitions of and differences between the two types of proprietary funds. Emphasize that the primary difference between the Enterprise Funds and Internal Service Funds is whether the majority of services are provided

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to other departments and agencies of the reporting government (Internal Service Funds) or to outside entities and individuals (Enterprise Funds).

- Understanding the definitions of and differences between the various types of governmental funds. Emphasize that the fundamental differences between any two governmental funds is the purpose(s) for which the fund resources are to be used. (Illustrations 2-8 through 2-10 may also be used to emphasize these points.)
- Mastering basic transaction analysis for governmental and proprietary funds. (Illustrations 2-6 and 2-7, Problems 2-1 through 2-4, and Case 2-2 in the text, as well as additional problems supplied within this manual are useful tools for teaching proper transaction analysis in the SLG environment.) Students who become proficient at transaction analysis in this chapter demonstrate a solid understanding of the government accounting and reporting model and thus tend to have a firm basis for mastering future chapters.
- Developing a basic understanding of the proprietary fund statement of revenues, expenses, and changes in fund net position (Illustration 2-11).
- Developing a basic understanding of the governmental fund statement of revenues, expenditures, and changes in fund balance (Illustration 2-11).
- Introducing the annual external financial reporting requirements. (Consider referring students to the financial statement examples in Chapter 13, specifically Illustrations 13-1 through 13-10, and 13-12.) Government-wide reporting should be introduced but should not be emphasized until you reach the reporting chapters—Chapters 13 through 15. (Illustration 14-1 on page 552 of the text may help students better visualize the differences and relationships between the fund financial statements and the government-wide financial statements.)

Teaching Funds, Fund Structure, and Transaction Analysis

Students often understand the concepts of fund accounting better if they are carefully led through a logical progression. One possibility is to teach:

- What a fund is.
- What a fund category is.
- What the three fund categories are.
- The accounting equation and the measurement focus for the proprietary fund category.
- Transaction analysis for the proprietary fund category (Illustration 2-6 and Exercise 2-10 (1) in the text).
- The accounting equation and the measurement focus for the governmental fund category.
- The absence of general government capital assets and general government long-term liabilities in the governmental funds.
- The use of nonfund general capital assets and general long-term liabilities accounts.

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- Transaction analysis for the governmental fund category, along with the General Capital Assets and General Long-Term Liabilities accounts (Illustration 2-7 and Exercise 2-10 (2) in the text).
- The two individual types of proprietary funds and how to distinguish between the two.
- The five individual types of governmental funds and how to distinguish among them.
- Practice transaction analysis using specific fund types (Problems 2-1 through 2-4 in the text).

Financial Statements

It is likely that students will be more successful in understanding and preparing the statement of revenues, expenditures, and changes in fund balance and the statement of revenues, expenses, and changes in fund net position if you simply have them memorize the formats for these critical financial statements. (Exercises 2-6 and 2-7 in the text provide students an opportunity to apply their understanding of these two financial statements.)

Have students note that when a transaction causes the fund balance of a governmental fund to change in the transaction analysis, this change must be reflected in the statement of revenues, expenditures, and changes in fund balance in some way. Then note that this statement includes three (or four) categories of increases and three (or four) categories of decreases. Because all but one of the increase categories and all but one of the decrease categories are used to present either a single type or a limited number of types of transactions, a student can become astute in preparing this statement with limited time and effort.

A simplistic way to illustrate the nature of a governmental fund balance sheet and operating statement with the accounting equation is to draw a horizontal box around the accounting equation and explain that this is a balance sheet. (A balance sheet is a detailed presentation of the accounting equation.) A vertical box that encloses fund balance at the top can represent the operating statement.

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Balance Sheet

(Financial Assets + Deferred Outflows of Resources)	−	(Related Liabilities + Deferred Inflows of Resources)	=	Fund Balance

Balance Sheet

(Financial Assets + Deferred Outflows of Resources)	−	(Related Liabilities + Deferred Inflows of Resources)	=	Fund Balance
				(1) Beginning balance (2) Operating Statement *Includes Increases in Fund Balance* Revenues Other Financing Sources Special Items Extraordinary Items AND *Decreases in Fund Balance* Expenditures Other Financing Uses Special Items Extraordinary Items

Some professors prefer to replace "Financial Assets" with "Current Assets" and "Related Liabilities" with "Current Liabilities" in the Balance Sheet equation. This may help students understand the accounting equations for governmental funds although it is not completely accurate.

QUESTIONS/EXERCISES/PROBLEMS — SUMMARY AND COMMENTARY

In the text

Number of Questions	18 (includes 1 research question)
Number of Exercises	10 (includes 2 exercises with 10 multiple choice questions each)
Number of Problems	6 (includes 4 transactional analysis problems)
Number of Cases	2 (includes fund identification and transaction analysis cases)

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Exercises 2-3 and 2-4 (also refer to additional exercise provided in this manual)

These are short exercises that can be used to illustrate fund classification and/or to gauge student understanding of fund classification.

Exercise 2-5

This exercise may be used to discuss the concept of expenditures in governmental funds.

Exercises 2-6 and 2-7

These are brief exercises that focus attention on the operating statements of governmental funds and of proprietary funds. Assigning both may highlight some of the differences between these statements and between reporting the flow of current financial resources versus reporting the flow of economic resources.

Exercises 2-8 and 2-9

These are brief exercises that focus attention on the balance sheets of governmental funds and proprietary funds. Assigning both may highlight some of the differences between these statements and between the current financial resources measurement focus and the economic resources measurement focus.

Exercise 2-10

In addition to being a transaction analysis, this exercise is an effective tool for helping students understand the differences between accounting for governmental funds and the nonfund accounts and accounting for proprietary funds. This is a good introductory assignment to help students understand the nature of a governmental fund versus the nature of a proprietary fund. Students are told to analyze the same set of transactions for a "generic" governmental fund and for a "generic" proprietary fund. For the first five transactions, the effect on fund equity is the same for the governmental fund analysis as it is for the proprietary fund analysis. Capital assets and long-term liabilities are introduced beginning in the sixth transaction. The analysis, therefore, differs considerably between the two categories of funds in several of the subsequent transactions. It follows the format of Illustrations 2-6 and 2-7. Problems 2-1 through 2-4 (also refer to numerous additional problems provided in this manual)

These problems reflect a variety of transaction analysis scenarios that require the student to identify the specific fund and/or nonfund accounts affected by each transaction and to explain how the transaction is reported in the appropriate operating statement of each fund affected. Mastering the material of this chapter to the point of being able to successfully analyze a wide variety of transactions is critical for a student's success and understanding in later chapters. The problems are great learning tools and it is better to assign too many of these problems rather than too few.

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Problems 2-5 and 2-6

These problems are designed to provide extensive comparisons and contrasts of the differing bases of accounting unique to the fund accounting environment.

Case 2-1

This is a short case that can be used to illustrate fund classification and/or to gauge student understanding of fund classification. Students could look at a recent State of California CAFR to find the answers to this case.

Case 2-2

This case is similar to the transaction analysis Problems 2-1 through 2-4. It should provide students with an opportunity to practice their transaction analysis skills by examining a variety of transactions that occurred at the Humble Independent School District.

Additional questions for in-class or homework assignments

1. What differences would you expect to find between the accounting principles for the General Fund and for Special Revenue Funds?

   Suggested Solution

   There should be no differences between the accounting principles for the General Fund and for Special Revenue Funds. The only difference between the two fund types is the functions or activities they might be used to finance. While the General Fund can usually be used for any reasonable governmental purpose agreed upon by the governing body, Special Revenue Fund resources are dedicated (usually by law, regulation, or contractual agreement) to one or a few specific purposes or activities.

2. Revenues or expenditures of a specific fund may not represent increases or decreases in the net position of the government as a whole. Why is this true?

   Suggested Solution

   Revenues or expenditures of a specific fund may not represent increases or decreases in the net position of the government as a whole because the focus of municipal accounting is upon the fund entities, not upon the government as an entity. Thus, a fund generally has "revenues" or incurs "expenditures" whenever its net position is increased or decreased, respectively (whether or not there have been increases or decreases in the net position of the government as a whole). However, interfund transfers, reimbursements, and bond issue proceeds do not give rise to fund revenues, expenditures, or expenses. The situation in question arises in cases such as these:

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- *When capital outlay expenditures from a fund result in the acquisition of an asset accounted for through the General Capital Assets and General Long-Term Liabilities accounts,*

  and

- *When indebtedness previously carried in the General Capital Assets and General Long-Term Liabilities accounts matures and is established as an expenditure and liability of, or is paid from, a specific fund.*

3. It has been asserted that terms such as *sources* and *uses* should be substituted for *revenues* and *expenditures,* respectively, in accounting and reporting for governmental (expendable) funds. Do you agree? Why or why not?

   <u>*Suggested Solution*</u>

   Yes *Inasmuch as expendable fund accounting is concerned principally with the inflows, outflows, and balances of appropriable financial resources—and is thus more akin to "funds flow" than "income determination" accounting—terms such as "sources" and "uses" would be more suitable than "revenues" and "expenditures." Although not discussed in the textbook, the GASB uses the terms "inflows of resources" and "outflows of resources" instead of "revenues" and "expenditures" in its Concepts Statement No. 4, Elements of Financial Statements. The use of terms, such as "sources" or "inflows of resources," might reduce the frequent confusion of the terms "expenditures" and "expenses."*

   -or-

   No *The terms "revenues" and "expenditures" have long been used in governmental accounting and reporting and do not confuse the knowledgeable reader of governmental fund financial statements. Inasmuch as they are widely understood, a change of terminology might cause more confusion. Further, the terms "sources" and "inflows of resources" include nonrevenue financing sources, as well as revenues, and the terms "uses" and "outflows of resources" encompass nonexpenditure financing uses as well as expenditures. Thus, "sources" and "uses" are not synonymous with "revenues" and "expenditures," respectively.*

   Grader Note*: The "Yes" or "No" answer is not important here. What is important is that the student demonstrates an awareness of (1) the similarity of expendable fund accounting of governments and "funds flow" analysis of business enterprises and, perhaps, (2) the other points of the suggested solutions above.*

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4. The principal financial statements of business enterprises are the balance sheet, income statement, and statement of cash flows. What similarities and differences are there between these statements and the operating and position statements of a proprietary fund? A governmental fund?

   Suggested Solution

   Proprietary (nonexpendable) fund *accounting and financial statements are quite similar to those of similar business enterprises because of the similarity of the underlying accounting models. The Statement of Net Position (Balance Sheet), Statement of Revenues, Expenses, and Changes in Fund Net Position, and Statement of Cash Flows constitute the principal financial statements of a government's proprietary (nonexpendable) funds. Though similar, there are notable differences between these statements and the corresponding business statements. The equity of a proprietary fund distinguishes the underlying nature of, or restrictions on, net position, not the sources from which the equity was derived. Different classifications and totals are used in the proprietary fund operating statement and cash flow statement.*

   Governmental (expendable) funds, *on the other hand, are comprised of financial assets and related liabilities. Governmental (expendable) fund accounting and reporting is therefore largely concerned with sources, uses, and balances of appropriable financial resources—not income determination—and expenditures are accounted for rather than expenses. Thus, the operating statement—the Statement of Revenues, Expenditures, and Changes in Fund Balance—somewhat resembles the Statement of Cash Flows of a commercial enterprise. This statement—prepared on both the GAAP basis and the budgetary basis—and the Balance Sheet comprise the principal financial statements prepared for governmental (expendable) funds.*

5. Harvey Township budgets its resources on the cash basis in accordance with state laws. State law also requires financial statements prepared on the cash basis. To comply with this requirement, Harvey Township prepares the financial statements in its comprehensive annual financial report (CAFR) on the cash basis rather than on the GAAP basis.
   a. Discuss the appropriateness of the statements in Harvey Township's CAFR.
   b. Explain what, if anything, Harvey Township should change in its CAFR.

   Suggested Solution

   a. Harvey Township's Comprehensive Annual Financial Report (CAFR) complies with the state laws but does not comply with generally accepted accounting principles (GAAP).

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b. *The CAFR should be changed so that the primary financial statements are presented in conformity with GAAP. The budgetary statement(s) would be prepared on the cash basis under GAAP, but the other statements would be prepared under the modified accrual or accrual basis, as appropriate. State reporting requirements may have to be met by including supplemental schedules in the CAFR or by issuing a special purpose report.*

6. The City of Horner's Corner publishes basic financial statements (BFS) and management's discussion and analysis (MD&A) but considers it unnecessary to publish a comprehensive annual financial report (CAFR). The city's only funds are a General Fund, three Special Revenue Funds, two Capital Projects Funds, an Internal Service Fund, and two Enterprise Funds. A citizen has asked you if this practice is appropriate according to GASB principles. Discuss.

   Suggested Solution

   The basic financial statements and notes—accompanied by Management's Discussion and Analysis and other required supplementary information—meet the minimum GAAP requirements for general purpose external financial reporting. Therefore, a CAFR is not required by the GASB principles. However, the GASB does recommend that this information be provided within the context of a Comprehensive Annual Financial Report.

7. The clerk of the town of Smallsville is willing to prepare the basic financial statements (BFS) required by the GASB but does not want to prepare the management's discussion and analysis (MD&A). Is this practice appropriate according to GASB standards?

   Suggested Solution

   ***No**. The GASB identifies the MD&A as part of the minimum requirements for general purpose external financial reporting. The MD&A is required supplementary information.*

Additional problems for in-class or homework assignments

Problem 2-1 (Fund and Nonfund Accounts Identification)

Using the appropriate fund and nonfund accounts abbreviations, indicate which governmental fund(s) and nonfund accounts might be used to account for the following items and give the reasons for your answer(s).

1. Revenues not restricted as to use
2. Revenues restricted for specified current operating purposes

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3. Purchase of equipment, furniture, and fixtures
4. Depreciation of equipment used in general government functions
5. Payment of short-term debt interest and principal
6. Payment of maturing long-term debt interest and principal
7. Construction of a major capital facility or improvement
8. Charges for services
9. Revenues restricted to payment of general obligation long-term debt interest and principal
10. Proceeds of long-term debt issuances

Solution Format

No.	Fund(s)	Accounts to Be Used	Reason(s)

Fund & Accounts Abbreviations	
GF	General Fund
SRF	Special Revenue Fund
CPF	Capital Projects Fund
DSF	Debt Service Fund
GCA/GLTL	General Capital Assets and Long-Term Liabilities accounts

Suggested Solution

No	***Fund(s) to Be Used***	***Reason (s)***
1.	*GF*	*Revenues are unrestricted.*
2.	*SRF*	*Usually, since restricted to certain operations.*
	GF	*Permitted if no requirement for SRF and management can assure compliance with restrictions in GF.*
3.	*GF*	*If recurring, minor capital outlay.*
	SRF	*If recurring, minor capital outlay from restricted resources.* *A SRF would not be used if the primary purpose of the fund is capital acquisitions.*
	CPF	*If part of major capital project.*
4.	*None*	*Depreciation is not an expenditure but will be reported in the government-wide financial statements.*
5.	*GF*	*If debt incurred for General Fund operating purposes.*
	SRF	*If debt incurred for Special Revenue Fund operating purposes (not if the primary purpose of the fund is debt issuance or repayment).*

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	CPF	*If debt incurred for a capital project.*
	PF	*If debt incurred for a Permanent Fund.*
6.	*DSF*	*Usually, as is function of DSF.*
	GF	*If debt serviced through GF (e.g., capital leases) rather than DSF.*
	CPF	*If debt service during construction is paid from CPF.*
	PF	*If debt is related to a Permanent Fund.*
7.	*CPF*	*Usually, as is purpose of CPF.*
8.	*GF*	*If revenues unrestricted as to use.*
	SRF	*If revenues restricted as to use.*
9.	*DSF*	*Usually, since DSF is for this purpose.*
	GF	*If no DSF required or used and can effectively control through GF.*
10.	*CPF*	*If for major capital project.*
	DSF	*If to refinance old long-term debt.*
	GF	*If to finance GF deficit or if nonmajor capital project financed through GF.*

Problem 2-2 (Transaction Analysis)

a. Analyze the effects of the following transactions on the accounting equations of the various funds and nonfund accounts of a state or local government. Identify the fund that typically would be used to record the transaction.
b. Indicate how each transaction would be reported in the operating statement for each fund affected.

Example: Cash received for licenses during 20X1, $8,000.
Answer:

		Governmental Funds					General Capital Assets and General Long-Term Liabilities Accounts				
No.	**Fund**	**FA**	**–**	**RL**	**=**	**FB**	**GCA**	**–**	**GLTL**	**=**	**NP**
E.	GF	$8,000				$8,000					

GF = General fund

Revenues of $8,000 reported in GF.

1. The government-owned and -operated electric utility billed users $2,000,000 for electricity usage. This included $100,000 billed to General Fund departments for electricity usage.

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2. $50,000 of General Fund money was loaned to a Capital Projects Fund to allow construction on a project to begin before the related bonds were issued. The loan is to be repaid in 6 months.
3. $1,000,000 of property taxes were levied during the year to provide financing for the budget of the year of levy; $800,000 was collected by year end. Another $85,000 was collected during the first 60 days of the next fiscal year. An additional $100,000 is expected to be collected during the remainder of the second fiscal year and $15,000 is estimated to be uncollectible.
4. The government issued a $7,000,000, 6 percent, 5-year note halfway through the fiscal year to provide partial financing for construction of a bridge.
5. The government issued a $1,000,000, 6 percent, 1-year note halfway through the fiscal year to provide temporary financing for a special program, which will be financed ultimately by reimbursements from a restricted grant awarded to the government for the specific purpose of financing that program. However, no cash has been received from the grantor to date.
6. A truck for a general government department was purchased for $40,000 cash.
7. Repaid outstanding general government bonds, $2,000,000, and paid $100,000 interest.
8. The 1-year note from transaction 5 matured and was paid along with the interest of $60,000.
9. A utility department truck was sold halfway through its useful life for $17,000. The truck, which originally cost $45,000, had accumulated depreciation of $30,000.

Suggested Solution

Problem 2-2(a)

		Governmental Funds					General Capital Assets and General Long-Term Liabilities Accounts				
	Fund	**FA**	**–**	**RL**	**=**	**FB**	**GCA**	**–**	**GLTL**	**=**	**NP**
1	GF and/or SRF			100,000		(100,000)					
2	GF*										
2	CPF	50,000		50,000							
3	GF	985,000		100,000**		885,000					
4	CPF	7,000,000				7,000,000			7,000,000		(7,000,000)
5	SRF	1,000,000		1,000,000							
5	SRF year-end accrual			30,000		(30,000)					
6	GF and/or SRF	(40,000)				(40,000)	40,000				40,000
7	DSF	(2,100,000)				(2,100,000)			(2,000,000)		2,000,000
8	SRF	(1,060,000)		(1,030,000)		(30,000)					

GF = General fund

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CF = Capital projects fund
DSF = Debt service fund
SRF = Special revenue fund
*Financial assets decreased (cash) and increased (due from capital projects fund).
**Deferred revenue

		Proprietary Funds								
	Fund	**CA**	**+**	**NCA**	**–**	**CL**	**–**	**LTL**	**=**	**NP**
1.	EF	2,000,000								2,000,000
9.	EF	17,000		(15,000)						2,000

EF = Enterprise fund

Problem 2-2(b)

1. Expenditures of $100,000 reported in GF and/or SRF. Revenues of $2,000,000 reported in EF.
2. No effect.
3. Property tax revenues of $885,000 reported in GF.
4. Other financing sources of $7,000,000 reported in CPF.
5. Year-end accrual of interest expenditures of $30,000 reported in SRF.
6. Expenditures of $40,000 reported GF and/or SRF.
7. Expenditures of $2,100,000 ($2,000,000 for bond principal and $100,000 for interest) reported in DSF.
8. Expenditures of $30,000 reported in SRF. (Remember—additional expenditures of $30,000 were reported in entry 5.)
9. Gain on sale of equipment of $2,000 reported in EF.

Problem 2-3 (Transaction Analysis)

a. Analyze the effects of each of the following transactions on the accounting equations of any fund or nonfund accounts of Segelquist County affected by the transaction. (Record any interest accruals that Segelquist would be required to make at year end.)
b. Also, indicate if and how each transaction would be reported in the operating statement of each of the affected funds. Be specific.

Example: Cash received for licenses during 20X1, $8,000.
Answer:

		Governmental Funds					General Capital Assets and General Long-Term Liabilities Accounts				
No.	**Fund**	**FA**	**–**	**RL**	**=**	**FB**	**GCA**	**–**	**GLTL**	**=**	**NP**
E.	GF	$8,000				$8,000					

GF = General fund

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Revenues of $8,000 reported in GF.

1. Segelquist County issued $5,000,000 of general obligation, 6 percent bonds on November 1, 20X5. Bond interest is payable semiannually on April 30 and October 31. The bonds mature in 20 years. December 31 is the end of the county fiscal year. The bonds were issued to finance construction of a new jail annex.
2. The county paid $4,000,000 to Jailbird Construction Company during November and December 20X5 for construction costs incurred on the jail annex. Jailbird billed Segelquist County another $900,000 upon completion of the jail on December 30, 20X5.
3. The Segelquist County board of supervisors voted to set the unused Jail Annex Bonds proceeds aside for future principal and interest payments on the bonds. This action complied with a requirement of the bond indenture and was accomplished on December 31, 20X5, in accordance with the board's directive.
4. The county purchased new furnishings for the jailhouse annex. The total cost of $500,000 was paid from unrestricted resources.
5. The county water and sewer department provides services to county residents at a charge that is established at a level intended to recover the costs of providing the goods and services. If the charges prove inadequate, the county subsidizes operations from unrestricted county resources. The county water and sewer department borrowed $5,000,000 by issuing 6 percent revenue bonds on November 1, 20X5. Bond interest is payable semiannually on April 30 and October 31. The bonds mature in 20 years. The bonds were issued to finance construction of a new water treatment plant.
6. The county made the first semiannual interest payment on the jail bonds at the due date, April 30, 20X6.

Suggested Solution

Problem 2-3(a)

		Governmental Funds					General Capital Assets and General Long-Term Liabilities Accounts				
	Fund	**FA**	**–**	**RL**	**=**	**FB**	**GCA**	**–**	**GLTL**	**=**	**NP**
1.	CPF	$5,000,000				$5,000,000			$5,000,000		($5,000,000)
2.	CPF	(4,000,000)		$900,000		(4,900,000)	$4,900,000				4,900,000
3.	CPF	(100,000)				(100,000)					
3.	DSF	100,000				100,000					
4.	GF	(500,000)				(500,000)	500,000				500,000
6.	DSF	(150,000)				(150,000)					

GF = General fund
CF = Capital projects fund
DSF = Debt service fund
SRF = Special revenue fund

Proprietary Funds

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	Fund	CA	+	NCA	–	CL	–	LTL	=	NP
5.	EF	$5,000,000						$5,000,000		
5.	EF Year-end accrual					$50,000*				($50,000)

EF = Enterprise fund
*$5,000,000 × 6% × 2/12 = $50,000

Problem 2-3(b)

1. Other financing sources of $5,000,000 reported in CPF.
2. Expenditures of $4,900,000 are reported.
3. Other financing use (transfer out) of $100,000 reported in CPF. Other financing source (transfer in) of $100,000 is reported in the DSF.
4. Expenditures of $500,000 reported in GF.
5. Interest expense of $50,000 reported in EF for accrual of two months of interest expense.
6. Expenditures of $150,000 are reported in DSF.

Problem 2-4 (Transaction Analysis)

a. Pavlock County entered into the following transactions. The county's fiscal year end is December 31. Analyze the effects of each transaction on the accounting equations of each fund or nonfund entity affected by the transaction. (Reflect any interest accruals that Pavlock County would be required to make at year end.)
b. Indicate how each transaction would be reported in the operating statement of each fund affected by the transaction.

Example: Cash received for licenses during 20X1, $8,000.
Answer:

		Governmental Funds					General Capital Assets and General Long-Term Liabilities Accounts				
No.	Fund	FA	–	RL	=	FB	GCA	–	GLTL	=	NP
E.	GF	$8,000				$8,000					

GF = General fund

Revenues of $8,000 reported in GF.

1. Pavlock County issued $20 million of general obligation, 10 percent, 10-year bonds at par on October 1, 20X8. Bond interest is payable semiannually on March 31 and September 30. The bonds were issued to finance construction of a new county office building.

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2. The county paid $4 million to Fancy Dan Construction Company during 20X8 for work completed during the year. The company billed the county another $1,000,000 for work performed during 20X8.
3. Reflect any interest accrual required or permitted at year end.
4. The county purchased a truck for a general government department. The truck cost $122,000, which was paid in cash.
5. In 20X9, the county paid $4,000,000 from its General Fund to the fund from which the bonds are to be repaid. The purpose of shifting the resources was to provide for the principal and interest payments to be made during the fiscal year.
6. The county paid the first interest payment on the bonds when due, March 31, 20X9.

Suggested Solution

Problem 2-4(a)

		Governmental Funds					General Capital Assets and General Long-Term Liabilities Accounts				
	Fund	**FA**	**–**	**RL**	**=**	**FB**	**GCA**	**–**	**GLTL**	**=**	**NP**
1.	CPF	20,000,000				20,000,000			20,000,000		(20,000,000)
2.	CPF	(4,000,000)		1,000,000		(5,000,000)	5,000,000				5,000,000
4.	GF	(122,000)				(122,000)	122,000				122,000
5.	GF	(4,000,000)				(4,000,000)					
5.	DSF	4,000,000				4,000,000					
6.	DSF	(1,000,000)				(1,000,000)					

GF = General fund
CF = Capital projects fund
DSF = Debt service fund
SRF = Special revenue fund

Problem 2-4(b)

1. Other financing sources of $20,000,000 reported in CPF.
2. Expenditures of $5,000,000 reported in CPF.
3. No entry is recorded because no interest expense is accrued on long-term debt in governmental funds.
4. Expenditures of $122,000 reported in GF.
5. Other financing use (transfer out) of $4,000,000 reported in GF. Other financing source (transfer in) of $4,000,000 reported in DSF.
6. Expenditures of $1,000,000 are reported.

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Governmental and Nonprofit Accounting

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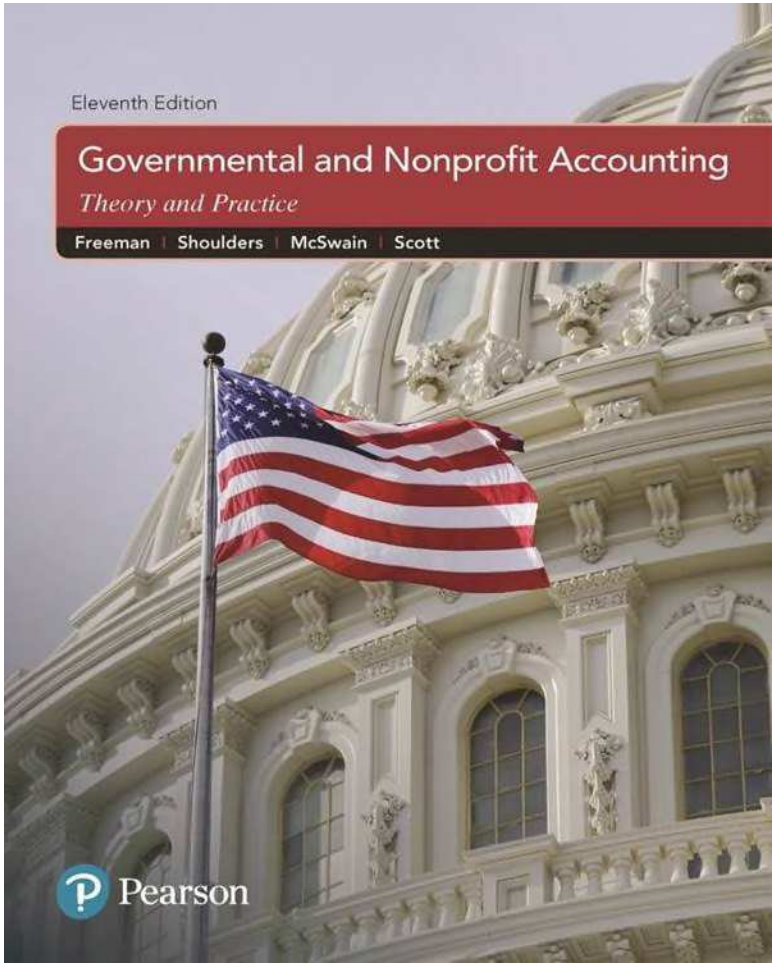

Chapter 2

State and Local Government Accounting and Financial Reporting Model: The Foundation

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Learning Objectives (1 of 3)

2.1 Visualize, summarize, and discuss the major overall aspects of the GASB state and local government financial reporting model, including the dual perspective of government-wide and fund financial statements.

2.2 Explain the fundamental features of the state and local government accounting and financial reporting model, including:

- Distinguishing the three broad categories of funds—governmental, proprietary, and fiduciary—and the specific types of funds in each fund category.

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Learning Objectives (2 of 3)

- Identifying and explaining the measurement focus and basis of accounting used for each category of funds and the financial statements required for funds of each category.
- Analyzing the effects of transactions on the proprietary fund and governmental fund categories and on the General Capital Assets and General Long-Term Liabilities accounts.

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Learning Objectives (3 of 3)

- Identifying typical budgetary accounting and reporting requirements.
- Explaining the financial reporting requirements for a government's basic financial statements and its comprehensive annual financial report.

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GASBS No. 34: Basis for Financial Reporting

- Issuance in 1999 marked a major change in governmental financial reporting
- Created dual perspective reporting:
  - Fund financial statements—detailed presentations
  - Government-wide financial statements—condensed consolidated overview

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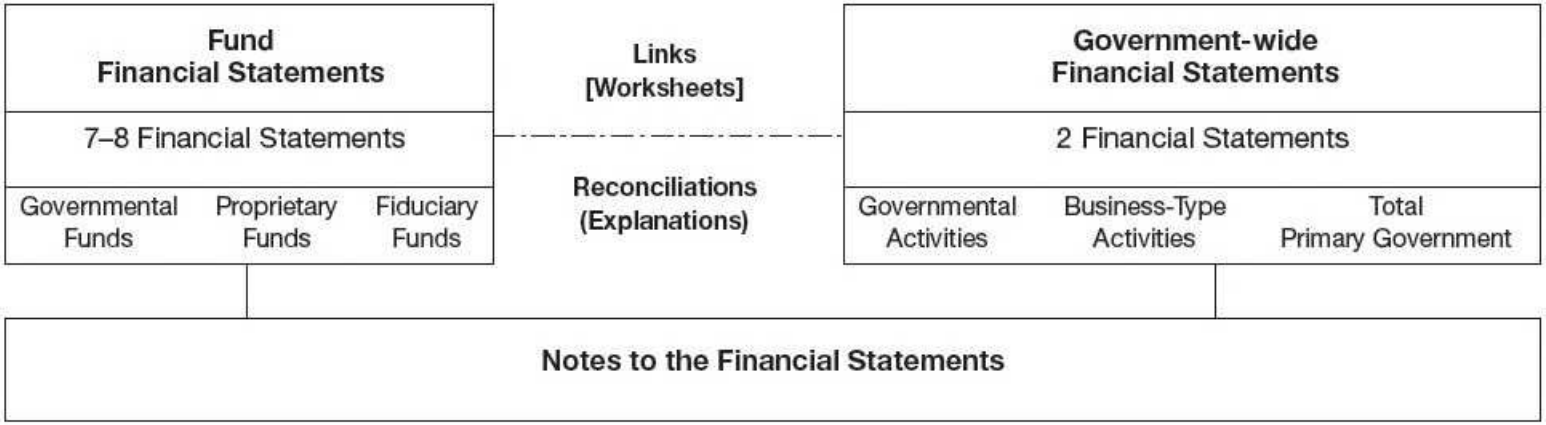
Basic Financial Statements: Overview



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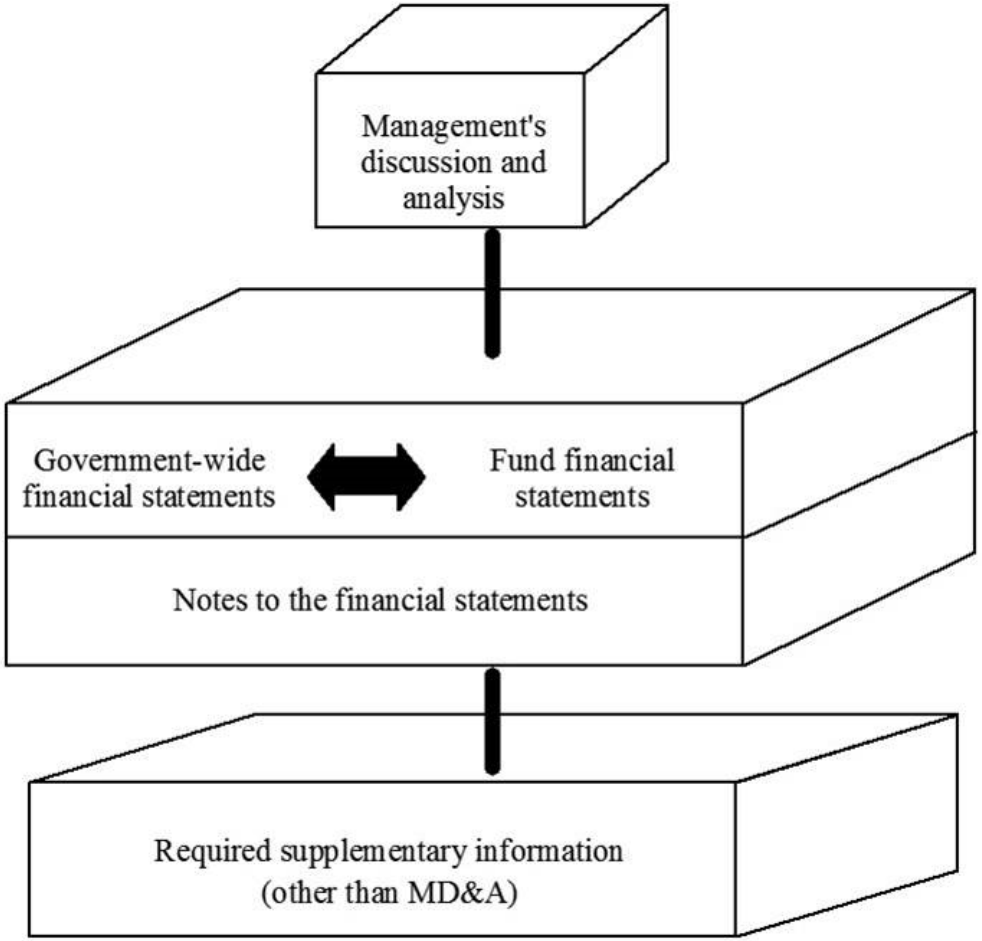
Minimum Requirements for External Financial Reporting: The GASB's View



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Fundamentals of SLG Accounting and Financial Reporting

1. GAAP and legal compliance
2. Fund accounting
3. Fund categories
4. Types of funds
5. Comparative financial statement formats
6. Annual financial reporting

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GAAP and Legal Compliance (1 of 3)

GAAP Reporting:

- Ensures that the financial reports of all SLGs contain the same types of financial statements and disclosures for the same types of funds and activities
- Requires “full” disclosure

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GAAP and Legal Compliance (2 of 3)

Legal Compliance:

- Ranges from simple to complex requirements
  - May be simple if budgeting on a GAAP basis
  - More complex if cash or encumbrance budgeting is required
- Identifying the budgetary basis is key

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GAAP and Legal Compliance (3 of 3)

Reconciling GAAP and legal requirements

- Maintain budgetary accounting control during the year
- Clearly distinguish between budgetary basis from GAAP basis
- Prepare statements and schedules using both bases and reconcile differences

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GAAP Requirements

- Trying to assure comparability among and between governments
- Full disclosure may result in much more information than "adequate" disclosure required by FASB

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Fund Accounting

- Most distinctive feature of governmental accounting
- Use of fund accounting allows for
  - Proper accounting controls
  - Demonstrating compliance
- Must understand fund structure, fund model, and interrelationships between funds

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Definition of a Fund

- Independent accounting entity with a self-balancing set of accounts
- Similar to a business accounting entity
  - Business entity captures all reported attributes for the entire business and all its transactions
  - Fund captures all reported attributes of a portion of the government's activities and resources accounted for in that fund

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Fund Categories

- Proprietary funds
- Governmental funds
- Fiduciary funds

Plus the Nonfund Accounts

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Proprietary Funds

- Similar to accounting for businesses
- Accounting measures net position, changes in net position, and cash flows

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Proprietary Funds:
Accounting Equation

Current Assets		Current Liabilities		
+		+		
Noncurrent Assets	–	Long-term Liabilities	=	Net Position
+		+		
Deferred Outflows of Resources		Deferred Inflows of Resources		

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Proprietary Funds: MFBA

- Measurement Focus (MF)
  - Economic resources
  - Financial statement recognition of all assets and all liabilities
- Basis of Accounting (BA)
  - Accrual
  - Recognize revenues when earned and expenses when incurred

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Governmental Funds

- Used to account for sources, uses, and balances of general government financial resources
- Funds represent segregations of general government net financial assets

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Governmental Funds:
Accounting Equation

Financial Assets + Deferred Outflows of Resources	–	Related Liabilities + Deferred Inflows of Resources	=	Fund Balance

Reporting Format

Assets + Deferred Outflows of Resources	=	Liabilities + Deferred Inflows of Resources	+	Fund Balance

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Governmental Funds: Accounting Equation Terms

- Financial Assets—refers primarily to cash, investments, and receivables
- Related Liabilities—related to the current year and normally paid for available current financial resources
- Fund Balance
  - Net financial assets of fund
  - Difference in financial assets and related liabilities

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Governmental Funds: MFBA

- Measurement focus—current financial resources
- Basis of accounting—modified accrual

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Governmental Funds:
Recognition Criteria—Revenues

- Earned during or levied for the period
- Objectively measurable
- Collected in period or soon enough thereafter (usually 60 days) to pay liabilities incurred for expenditures of the period (available)

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Governmental Funds:
Recognition Criteria—Expenditures

- When operating or capital outlay: liabilities to be paid currently from governmental funds are incurred
- When debt service (principal and interest): payments on long-term liabilities are due

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Expenditure/Expense Comparison

	Expenditures (net financial assets expended)	Expenses (cost of goods or services used)
Operating	Salaries, supplies, utilities, etc.	Salaries, supplies, utilities, etc.
Capital Outlay	Acquisition	Depreciation
Debt Service	Principal and Interest	Interest

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Deferred Outflows and Deferred Inflows of Resources

- Introduced in GASB Concepts *Statement No. 4*
- Included in standards on derivatives and service concessionaire arrangements
- Financial statements expanded to include classifications in GASBS No. 63
- Broader application made in GASBS No. 65

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Deferred Outflows and Deferred Inflows: Defined

- Deferred Outflows of Resources: consumption of net assets by the government that is applicable to a future reporting period
- Deferred Inflows of Resources: acquisition of net assets by the government that is applicable to a future reporting period

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Common Examples of Deferred Inflows in Governmental Funds

- Taxes collected in advance of the period for which they are levied
- Taxes levied in the current period to finance next period
- Revenues deferred due to availability criterion

Other specific examples will be discussed when certain conditions arise in the text.

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Nonfund Accounts

- General Capital Assets: not financial resources available for expenditure, but must maintain accountability
- General Long-term Liabilities: unmatured principal that does not require current appropriation or expenditure of fund financial resources

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Nonfund Accounts:
General Capital Assets

- Capital assets used in general government activities
- Not assets of any fund but of the governmental unit as a whole
- Inclusion in governmental fund financial statements would increase fund balance and could mislead users

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Nonfund Accounts:
General Long-Term Liabilities

- Secured by the general credit and revenue-raising powers of the government
- Not liabilities of any fund but of general government as a whole
- Inclusion in governmental fund liability would be misleading and dysfunctional to current period management control

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Nonfund Accounts:
Accounting Equation

General Capital Assets (GCA)	–	Unmatured General Long-Term Liabilities (GLTL)	=	Net Position (NP)

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Fiduciary Funds

- Accounts for assets held by government in trustee or agency capacity for others
- Not used to report assets held for government's own use

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Fiduciary Funds:
Accounting Equation

Assets		Liabilities		
+	–	+	=	Net Position
Deferred Outflows of Resources		Deferred Inflows of Resources		

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Fiduciary Funds: MFBA

- Measurement focus: economic resources
- Basis of accounting: accrual

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Categories and Types of Funds

GOVERNMENTAL FUNDS

- General Fund
- Special Revenue Funds
- Capital Projects Funds
- Debt Service Funds
- Permanent Funds

PROPRIETARY FUNDS

- Enterprise Funds
- Internal Service Funds

FIDUCIARY FUNDS

- Pension Trust Funds
- Investment Trust Funds
- Agency Funds
- Private Purpose Trust Funds

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Types of Proprietary Funds

- Enterprise Funds: customers are usually the general public (as well as businesses and other entities besides the government's own departments or agencies (Chapter 10))
- Internal Service Funds: customers are predominantly other departments or agencies of the government (Chapter 11)

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Types of Governmental Funds (1 of 3)

- General Fund: used to account and report all financial resources not accounted for and reported in another fund (Chapters 4–6)
- Special Revenue Funds: used to account for the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes (Chapters 4–6)

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Types of Governmental Funds (2 of 3)

- Capital Projects Funds: used to account for and report financial resources that are restricted, committed, or assigned to expenditure for capital outlays, including acquisition or construction of capital facilities or other capital assets (Chapter 7)
- Debt Service Funds: used to account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest (Chapter 8)

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Types of Governmental Funds (3 of 3)

- Permanent Funds: used to account for resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting government's programs—that is, for the benefit of the government or its citizenry
(Chapter 9)

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Types of Fiduciary Funds (1 of 2)

- Pension (and other employee benefit) Trust Funds: established to account for resources that are required to be held in trust for the members and beneficiaries of defined benefit pension plans, defined contribution plans, other post-employment benefit plans, and other employee benefit plans
- Investment Trust Funds: used to account for the external portion of investment pools held by the sponsoring government

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Types of Fiduciary Funds (2 of 2)

- Private-Purpose Trust Funds: used to account for all other trust arrangements under which principal and/or income benefit individuals or groups outside the government
- Agency Funds: established to account for resources held in a purely custodial capacity for others.

All Fiduciary Funds are discussed in Chapter 12.

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Interfund Transactions (1 of 2)

- Reciprocal:
  - Interfund loans
  - Interfund services provided and used
- Nonreciprocal:
  - Interfund reimbursements
  - Interfund transfers

Of particular interest here are loans and transfers.

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Interfund Transactions (2 of 2)

Loans

- Amounts provided by one fund to another with a requirement for repayment
- Affects only balance sheet accounts

Transfers

- Flows of assets from one fund to another with no requirement for repayment
- Affects balance sheet and operating statement accounts

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Comparative Operating Statements

Proprietary Funds

- Accrual-based
- Must distinguish between operating and non-operating revenues and expenses
- Separate reporting for capital contributions, special and extraordinary items, and transfers
- Change in Net Position

Governmental Funds

- Modified accrual-based
- Report revenues by source and expenditures by character
- Other financing sources and uses for other resource flows, including transfers
- Special and extraordinary items reported separately
- Change in Fund Balance

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Comparative Balance Sheets

Proprietary Funds

- Current and Noncurrent Assets
- Deferred Outflows of Resources
- Current and Noncurrent Liabilities
- Deferred Inflows of Resources
- Net Position

Governmental Funds

- Financial Assets
- Deferred Outflows of Resources
- Related Liabilities
- Deferred Inflows of Resources
- Fund Balance

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Annual Financial Reporting (1 of 12)

- Comprehensive Annual Financial Report (CAFR)
- Should be prepared for all governmental entities
- Sections include:
  - Introductory: little GAAP for this section
  - Financial: most GASB standards apply to this section
  - Statistical: see recently issued GASBS No. 44

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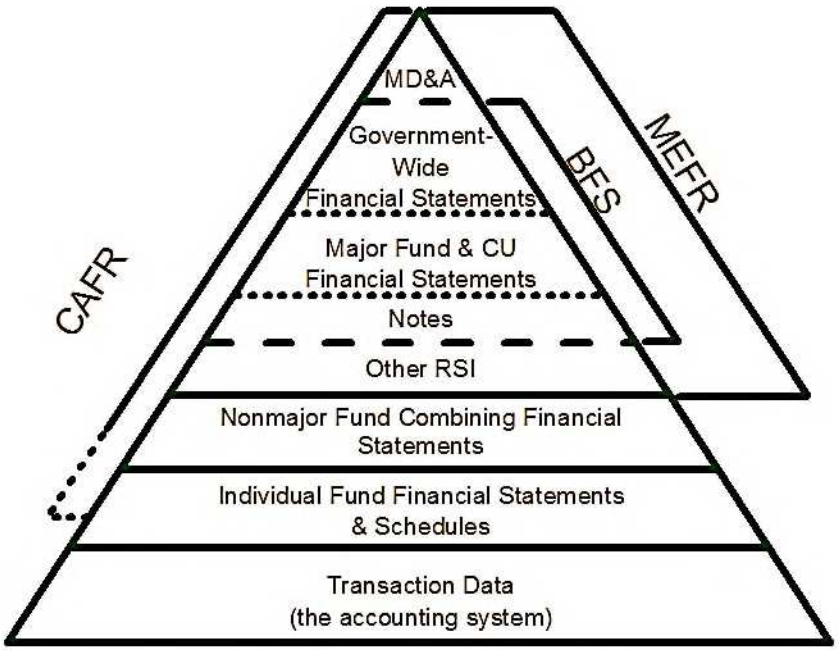
Annual Financial Reporting (2 of 12)



CAFR--Comprehensive Annual Financial Report
BFS--Basic Financial Statements
MEFR--Minimum External Financial Reporting

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Annual Financial Reporting (3 of 12)

Minimum reporting requirements:

- Management's Discussion and Analysis
- Basic Financial Statements
  - Government-wide financial statements
  - Fund financial statements
  - Notes to the financial statements
- Required supplementary information other than MD&A

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Annual Financial Reporting (4 of 12)

Financial Reporting Entity consists of

- Primary government (PG)
- Organizations for which the PG is financially accountable
- Other organizations whose omission would cause financial statements to be misleading

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Annual Financial Reporting (5 of 12)

Management's Discussion and Analysis:

- Brief discussion of financial statements
- Condensed government-wide financial information
- Analysis of position and results of operations
- Analysis of individual funds
- Budget analysis
- Significant capital assets and LTL events
- Modified approach
- Description of currently known facts

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Annual Financial Reporting (6 of 12)

Government-wide financial statements should include separate columns for Governmental Activities, Business-Type Activities, Total column for PG, and discretely presented component units

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Annual Financial Reporting (7 of 12)

Fund Financial Statements include major funds individually and nonmajor funds in the aggregate

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Annual Financial Reporting (8 of 12)

Financial Reporting Entity:

- Nucleus is the PG
- Other activities include:
  - Discretely presented component units
  - Blended component units
  - Joint ventures
  - Jointly governed organizations
  - Related organizations

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Annual Financial Reporting (9 of 12)

Government-Wide Financial Statements

- Statement of Net Position
- Statement of Activities

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Annual Financial Reporting (10 of 12)

Governmental Fund Statements (Schedules):

- Balance Sheet
- Statement or Revenues, Expenditures, and Changes in Fund Balance
- Statement or Revenues, Expenditures, and Changes in Fund Balance—Budget-to-Actual (may be either BFS or RSI)

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Annual Financial Reporting (11 of 12)

Proprietary Fund Statements:

- Statement of Net Position / Balance Sheet
- Statement of Revenues, Expenses, and Changes in Fund Net Position
- Statement of Cash Flows

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Annual Financial Reporting (12 of 12)

Fiduciary Fund Financial Statements:

- Statement of Fiduciary Fund Net Position
- Statement of Changes in Fiduciary Fund Net Position

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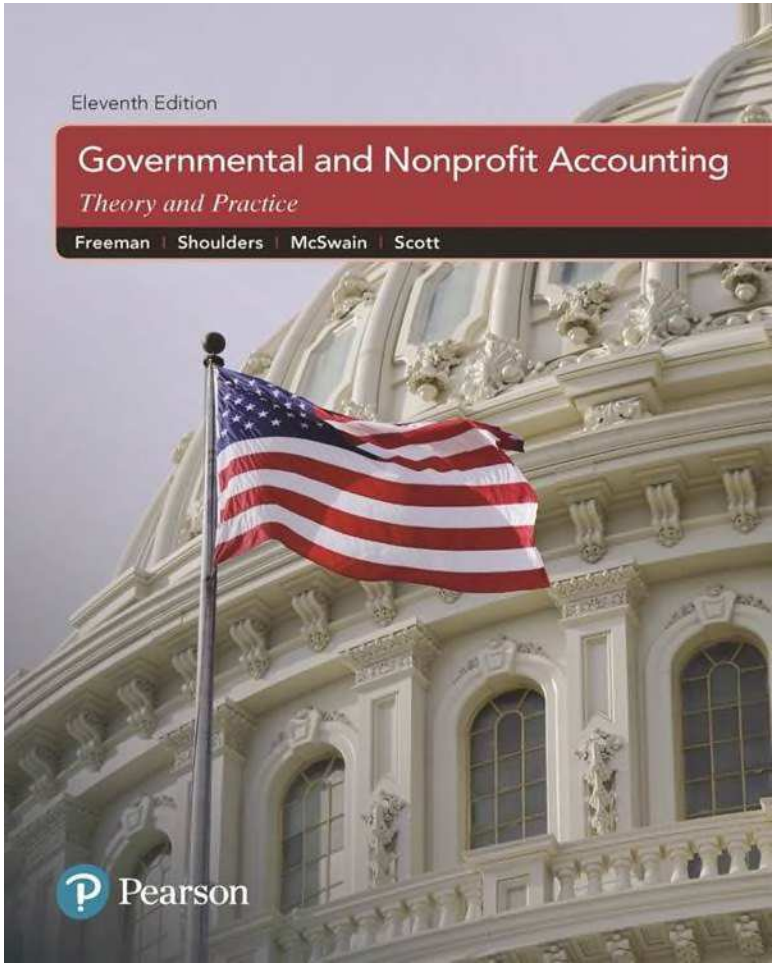
Governmental and Nonprofit Accounting

Eleventh Edition



Chapter 2

State and Local Government Accounting and Financial Reporting Model: The Foundation

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Learning Objectives (1 of 3)

2.1 Visualize, summarize, and discuss the major overall aspects of the GASB state and local government financial reporting model, including the dual perspective of government-wide and fund financial statements.

2.2 Explain the fundamental features of the state and local government accounting and financial reporting model, including (continued on next slide):

- Distinguishing the three broad categories of funds—governmental, proprietary, and fiduciary—and the specific types of funds in each fund category.

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Learning Objectives (2 of 3)

- Identifying and explaining the measurement focus and basis of accounting used for each category of funds and the financial statements required for funds of each category.
- Analyzing the effects of transactions on the proprietary fund and governmental fund categories and on the General Capital Assets and General Long-Term Liabilities accounts.

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Learning Objectives (3 of 3)

- Identifying typical budgetary accounting and reporting requirements.
- Explaining the financial reporting requirements for a government's basic financial statements and its comprehensive annual financial report.

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GASBS No. 34: Basis for Financial Reporting

- Issuance in 1999 marked a major change in governmental financial reporting
- Created dual perspective reporting:
  - Fund financial statements: detailed presentations
  - Government-wide financial statements: condensed consolidated overview

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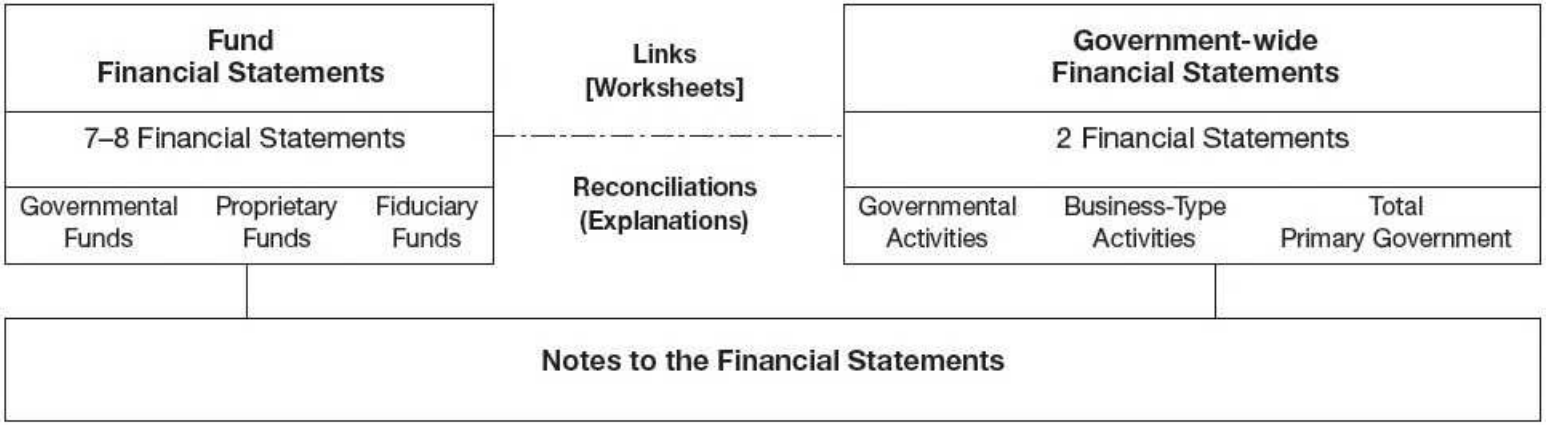
Basic Financial Statements: Overview



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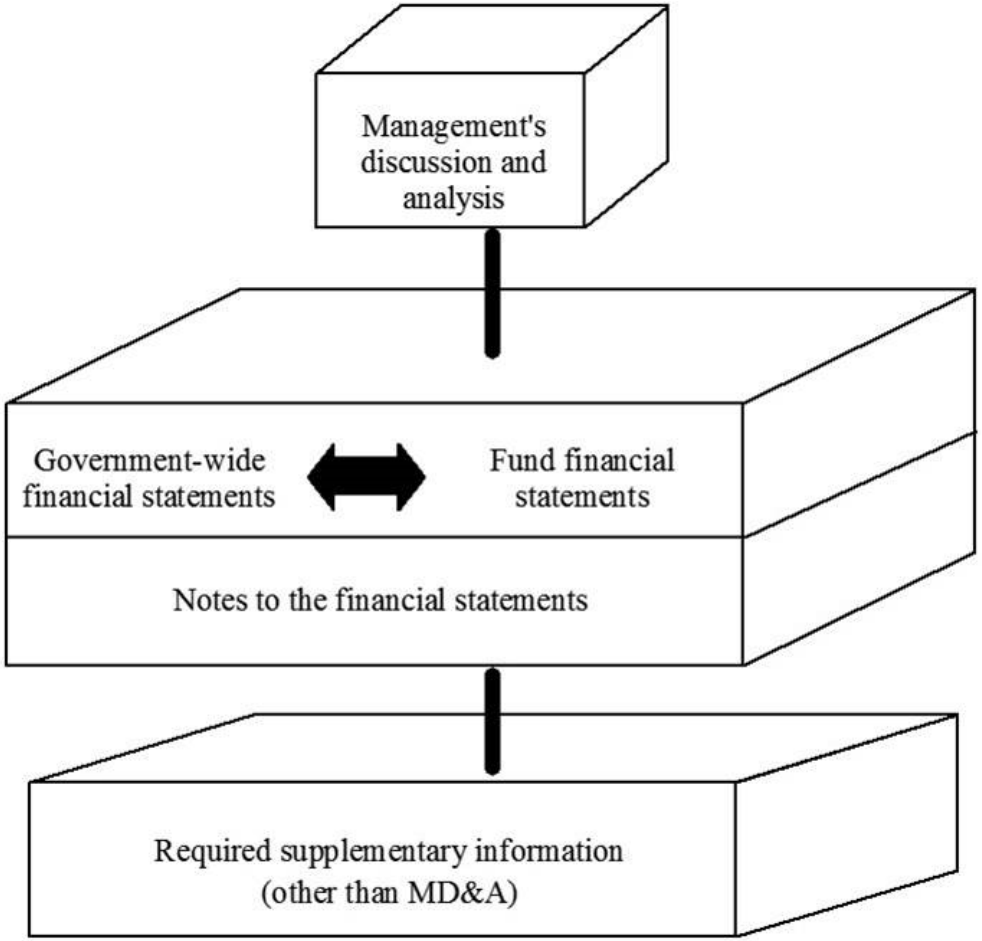
Minimum Requirements for External Financial Reporting: The GASB's View



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Fundamentals of SLG Accounting and Financial Reporting

1. GAAP and legal compliance
2. Fund accounting
3. Fund categories
4. Types of funds
5. Comparative financial statement formats
6. Annual financial reporting

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GAAP and Legal Compliance (1 of 3)

GAAP Reporting:

- Ensures that the financial reports of all SLGs contain the same types of financial statements and disclosures for the same types of funds and activities
- Requires “full” disclosure

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GAAP and Legal Compliance (2 of 3)

Legal Compliance:

- Ranges from simple to complex requirements
  - May be simple if budgeting on a GAAP basis
  - More complex if cash or encumbrance budgeting is required
- Identifying the budgetary basis is key

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GAAP and Legal Compliance (3 of 3)

- Reconciling GAAP and legal requirements
- Maintain budgetary accounting control during the year
- Clearly distinguish between budgetary basis from GAAP basis
- Prepare statements and schedules using both bases and reconcile differences

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GAAP Requirements

- Trying to assure comparability among and between governments
- Full disclosure may result in much more information than "adequate" disclosure required by FASB

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Fund Accounting

- Most distinctive feature of governmental accounting
- Use of fund accounting allows for
  - Proper accounting controls
  - Demonstrating compliance
- Must understand fund structure, fund model, and interrelationships between funds

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Definition of a Fund

- Independent accounting entity with a self-balancing set of accounts
- Similar to a business accounting entity
  - Business entity captures all reported attributes for the entire business and all its transactions
  - Fund captures all reported attributes of a portion of the government's activities and resources accounted for in that fund

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Fund Categories

- Proprietary funds
- Governmental funds
- Fiduciary funds

Plus the Nonfund Accounts

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Proprietary Funds

- Similar to accounting for businesses
- Accounting measures net position, changes in net position, and cash flows

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Proprietary Funds: Accounting Equation

Current Assets		Current Liabilities		
+		+		
Noncurrent Assets	–	Long-Term Liabilities	=	Net Position
+		+		
Deferred Outflows of Resources		Deferred Inflows of Resources		

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Proprietary Funds: MFBA

- Measurement Focus (MF)
  - Economic resources
  - Financial statement recognition of all assets and all liabilities
- Basis of Accounting (BA)
  - Accrual
  - Recognize revenues when earned and expenses when incurred

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Governmental Funds

- Used to account for sources, uses, and balances of general government financial resources
- Funds represent segregations of general government net financial assets

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Governmental Funds: Accounting Equation

Financial Assets		Related Liabilities		Fund
+	–	+	=	Balance
Deferred Outflows		Deferred Inflows		
of Resources		of Resources		

Reporting Format

Assets		Liabilities		Fund
+	=	+	+	Balance
Deferred Outflows		Deferred Inflows		
of Resources		of Resources		

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Governmental Funds: Accounting Equation Terms

- Financial Assets: refers primarily to cash, investments, and receivables
- Related Liabilities: related to the current year and normally paid for available current financial resources
- Fund Balance
  - Net financial assets of fund
  - Difference in financial assets and related liabilities

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Governmental Funds: MFBA

- Measurement focus: current financial resources
- Basis of accounting: modified accrual

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Governmental Funds:
Recognition Criteria—Revenues

- Earned during or levied for the period
- Objectively measurable
- Collected in period or soon enough thereafter (usually 60 days) to pay liabilities incurred for expenditures of the period (available)

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Governmental Funds:
Recognition Criteria—Expenditures

- When operating or capital outlay: liabilities to be paid currently from governmental funds are incurred
- When debt service (principal and interest): payments on long-term liabilities are due

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Expenditure/Expense Comparison

	Expenditures (net financial assets expended)	Expenses (cost of goods or services used)
Operating	Salaries, supplies, utilities, etc.	Salaries, supplies, utilities, etc.
Capital Outlay	Acquisition	Depreciation
Debt Service	Principal and Interest	Interest

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Deferred Outflows and Deferred Inflows of Resources

- Introduced in GASB Concepts *Statement No. 4*
- Included in standards on derivatives and service concessionaire arrangements
- Financial statements expanded to include classifications in GASBS No. 63
- Broader application made in GASBS No. 65

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Deferred Outflows and Deferred Inflows: Defined

- Deferred Outflows of Resources: consumption of net assets by the government that is applicable to a future reporting period
- Deferred Inflows of Resources: acquisition of net assets by the government that is applicable to a future reporting period

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Common Examples of Deferred Inflows in Governmental Funds

- Taxes collected in advance of the period for which they are levied
- Taxes levied in the current period to finance next period
- Revenues deferred due to availability criterion

Other specific examples will be discussed when certain conditions arise in the text.

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Nonfund Accounts

- General Capital Assets: not financial resources available for expenditure, but must maintain accountability
- General Long-Term Liabilities: unmatured principal that does not require current appropriation or expenditure of fund financial resources

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Nonfund Accounts:
General Capital Assets

- Capital assets used in general government activities
- Not assets of any fund but of the governmental unit as a whole
- Inclusion in governmental fund financial statements would increase fund balance and could mislead users

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Nonfund Accounts:
General Long-Term Liabilities

- Secured by the general credit and revenue-raising powers of the government
- Not liabilities of any fund but of general government as a whole
- Inclusion as governmental fund liability would be misleading and dysfunctional to current period management control

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Nonfund Accounts:
Accounting Equation

General Capital Assets (GCA)	–	Unmatured General Long-Term Liabilities (GLTL)	=	Net Position (NP)

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Fiduciary Funds

- Accounts for assets held by government in trustee or agency capacity for others
- Not used to report assets held for government's own use

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Fiduciary Funds:
Accounting Equation

Assets		Liabilities		
+	–	+	=	Net Position
Deferred Outflows		Deferred Inflows		
of Resources		of Resources		

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Fiduciary Funds: MFBA

- Measurement focus: economic resources
- Basis of accounting: accrual

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Categories and Types of Funds

GOVERNMENTAL FUNDS

- General Fund
- Special Revenue Funds
- Capital Projects Funds
- Debt Service Funds
- Permanent Funds

PROPRIETARY FUNDS

- Enterprise Funds
- Internal Service Funds

FIDUCIARY FUNDS

- Pension Trust Funds
- Investment Trust Funds
- Agency Funds
- Private Purpose Trust Funds

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Types of Proprietary Funds

- Enterprise Funds: customers are usually the general public (as well as businesses and other entities besides the government's own departments or agencies (Chapter 10))
- Internal Service Funds: customers are predominantly other departments or agencies of the government (Chapter 11)

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Types of Governmental Funds (1 of 3)

- General Fund: used to account and report all financial resources not accounted for and reported in another fund (Chapters 4–6)
- Special Revenue Funds: used to account for the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes (Chapters 4–6)

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Types of Governmental Funds (2 of 3)

- Capital Projects Funds: used to account for and report financial resources that are restricted, committed, or assigned to expenditure for capital outlays, including acquisition or construction of capital facilities or other capital assets (Chapter 7)
- Debt Service Funds: used to account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest (Chapter 8)

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Types of Governmental Funds (3 of 3)

- Permanent Funds: used to account for resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting government's programs—that is, for the benefit of the government or its citizenry
(Chapter 9)

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Types of Fiduciary Funds (1 of 2)

- Pension (and other employee benefit) Trust Funds: established to account for resources that are required to be held in trust for the members and beneficiaries of defined benefit pension plans, defined contribution plans, other post-employment benefit plans, and other employee benefit plans
- Investment Trust Funds: used to account for the external portion of investment pools held by the sponsoring government

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Types of Fiduciary Funds (2 of 2)

- Private-Purpose Trust Funds: used to account for all other trust arrangements under which principal and/or income benefit individuals or groups outside the government
- Agency Funds: established to account for resources held in a purely custodial capacity for others

All Fiduciary Funds are discussed in Chapter 12.

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Interfund Transactions (1 of 2)

- Reciprocal:
  - Interfund loans
  - Interfund services provided and used
- Nonreciprocal:
  - Interfund reimbursements
  - Interfund transfers

Of particular interest here are loans and transfers.

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Interfund Transactions (2 of 2)

Loans

- Amounts provided by one fund to another with a requirement for repayment
- Affects only balance sheet accounts

Transfers

- Flows of assets from one fund to another with no requirement for repayment
- Affects balance sheet and operating statement accounts

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Comparative Operating Statements

Proprietary Funds

- Accrual-based
- Must distinguish between operating and non-operating revenues and expenses
- Separate reporting for capital contributions, special and extraordinary items, and transfers
- Change in Net Position

Governmental Funds

- Modified accrual-based
- Report revenues by source and expenditures by character
- Other financing sources and uses for other resource flows, including transfers
- Special and extraordinary items reported separately
- Change in Fund Balance

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Comparative Balance Sheets

Proprietary Funds

- Current and Noncurrent Assets
- Deferred Outflows of Resources
- Current and Noncurrent Liabilities
- Deferred Inflows of Resources
- Net Position

Governmental Funds

- Financial Assets
- Deferred Outflows of Resources
- Related Liabilities
- Deferred Inflows of Resources
- Fund Balance

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Annual Financial Reporting (1 of 12)

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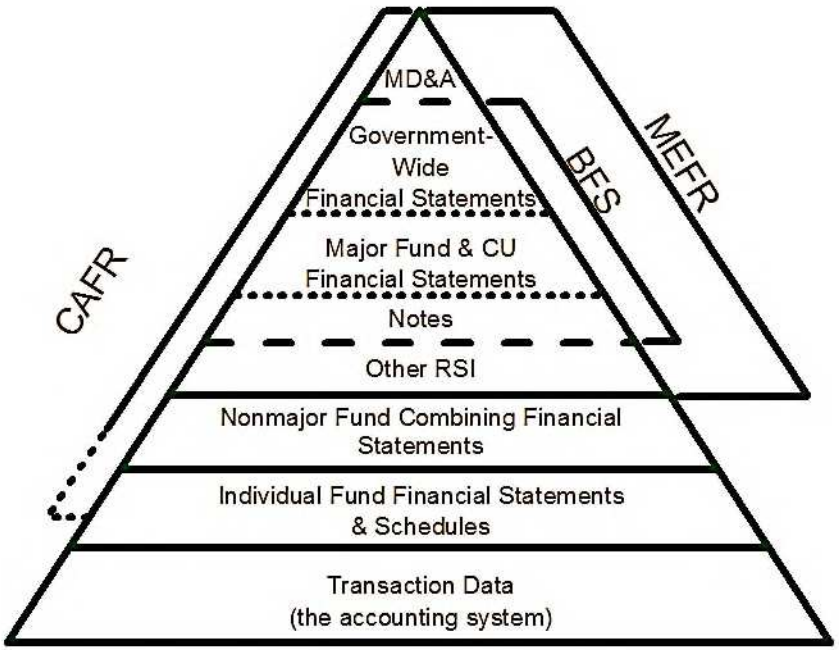

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Annual Financial Reporting (7 of 12)

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Annual Financial Reporting (8 of 12)

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Annual Financial Reporting (9 of 12)

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Annual Financial Reporting (10 of 12)

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Annual Financial Reporting (11 of 12)

Proprietary Fund Statements:

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- Statement of Revenues, Expenses, and Changes in Fund Net Position
- Statement of Cash Flows

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Annual Financial Reporting (12 of 12)

Fiduciary Fund Financial Statements:

- Statement of Fiduciary Fund Net Position
- Statement of Changes in Fiduciary Fund Net Position

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Preparation Process: Step 1

Transaction Data

Start with the transaction data—the basic building blocks for everything in the Comprehensive Annual Financial Report (CAFR)

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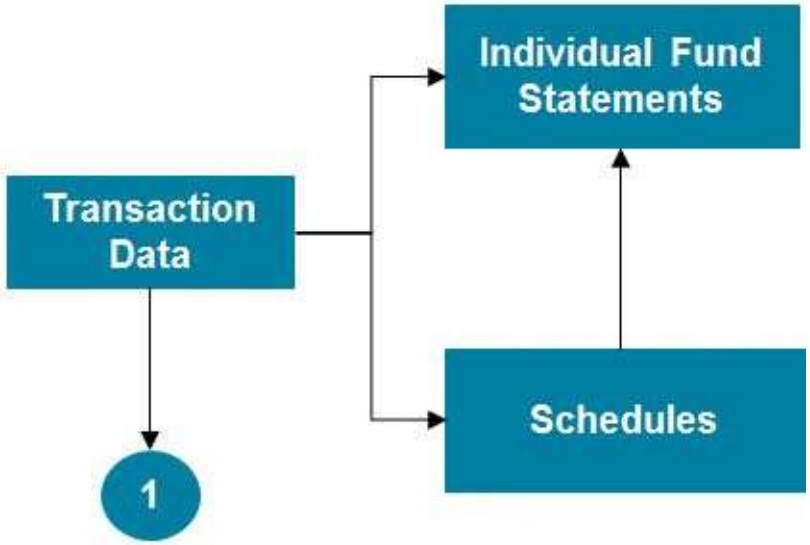
Preparation Process: Step 2



From the transaction data, prepare the individual fund financial statements and schedules. Also, some of the transaction data will be used later in the CAFR preparation process.

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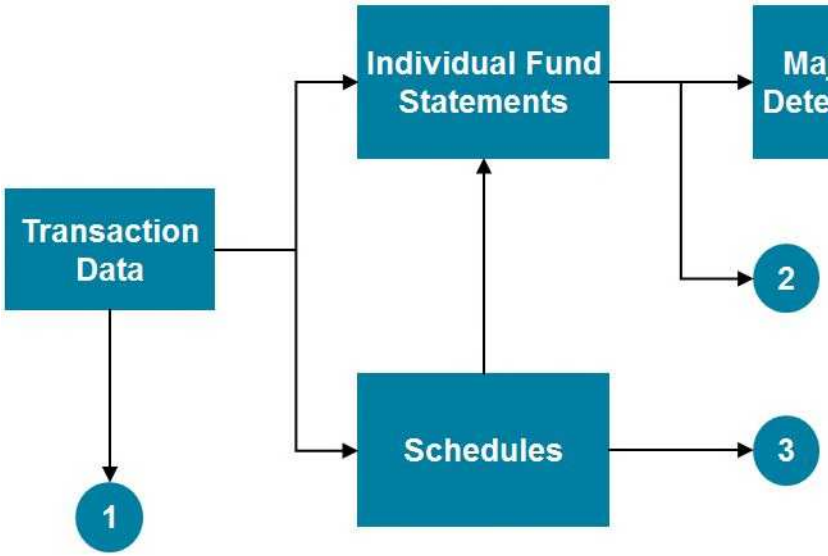
Preparation Process: Step 3



Determine the major funds (this process will be discussed later). Also, information from the individual fund statements and schedules will be used later in the process.

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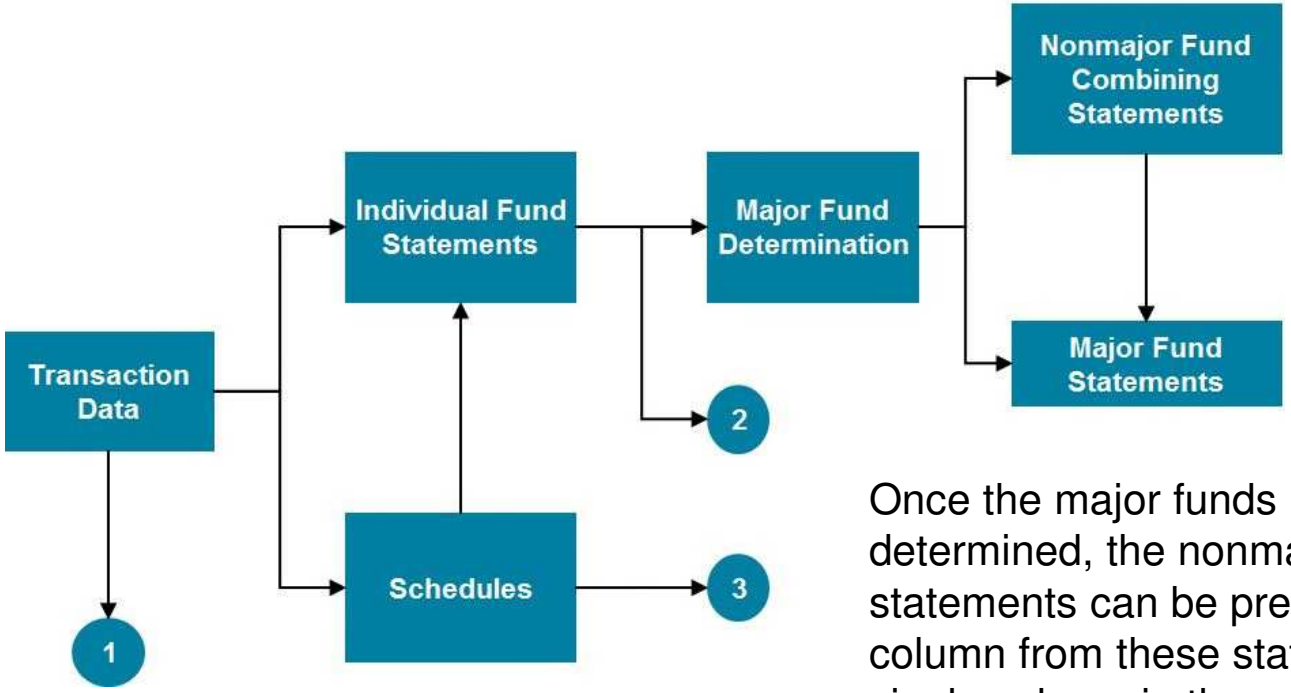
Preparation Process: Step 4



Once the major funds have been determined, the nonmajor fund combining statements can be prepared. The total column from these statements becomes a single column in the major fund statements along with a separate column for each major fund.

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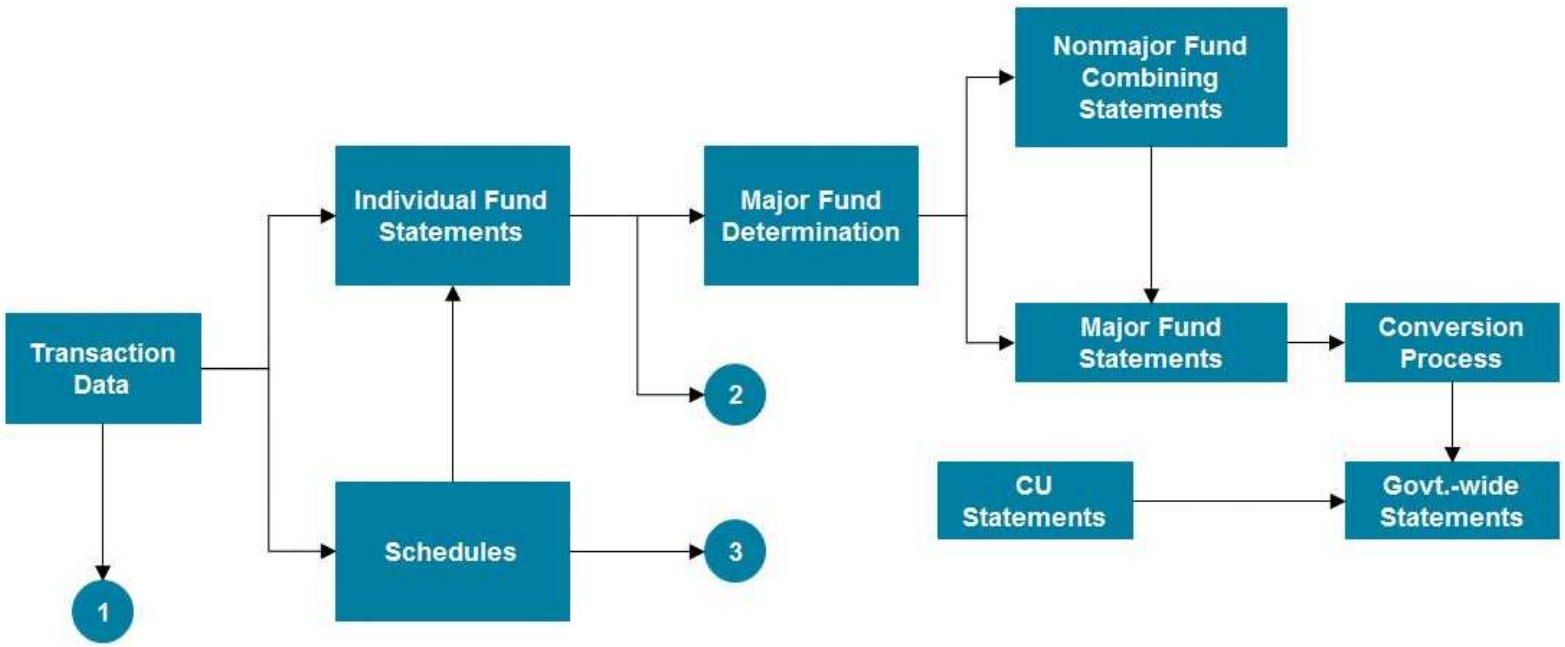
Preparation Process: Step 5



The major funds statements undergo a conversion process and are combined with the component units financial statements to complete the government-wide statements.

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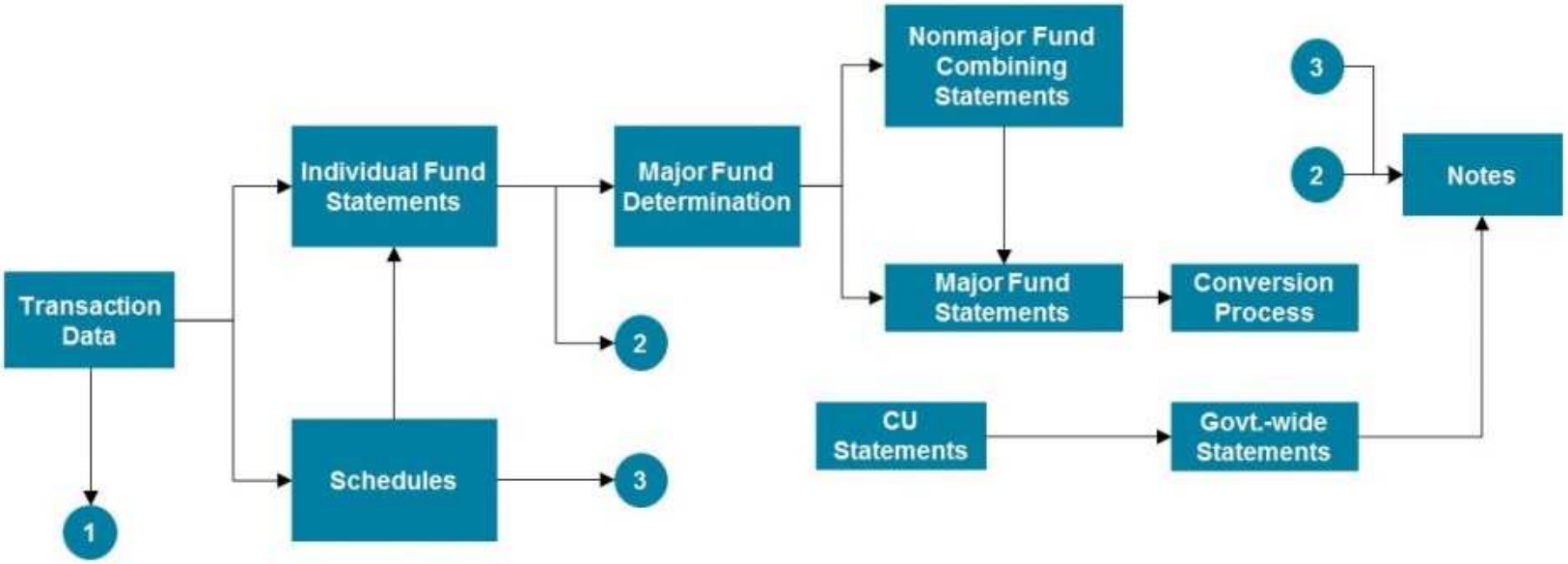
Preparation Process: Step 6



Information from all the financial statements and the schedules are used to prepare the notes to the financial statements. This process completes the Basic Financial Statements (BFS).

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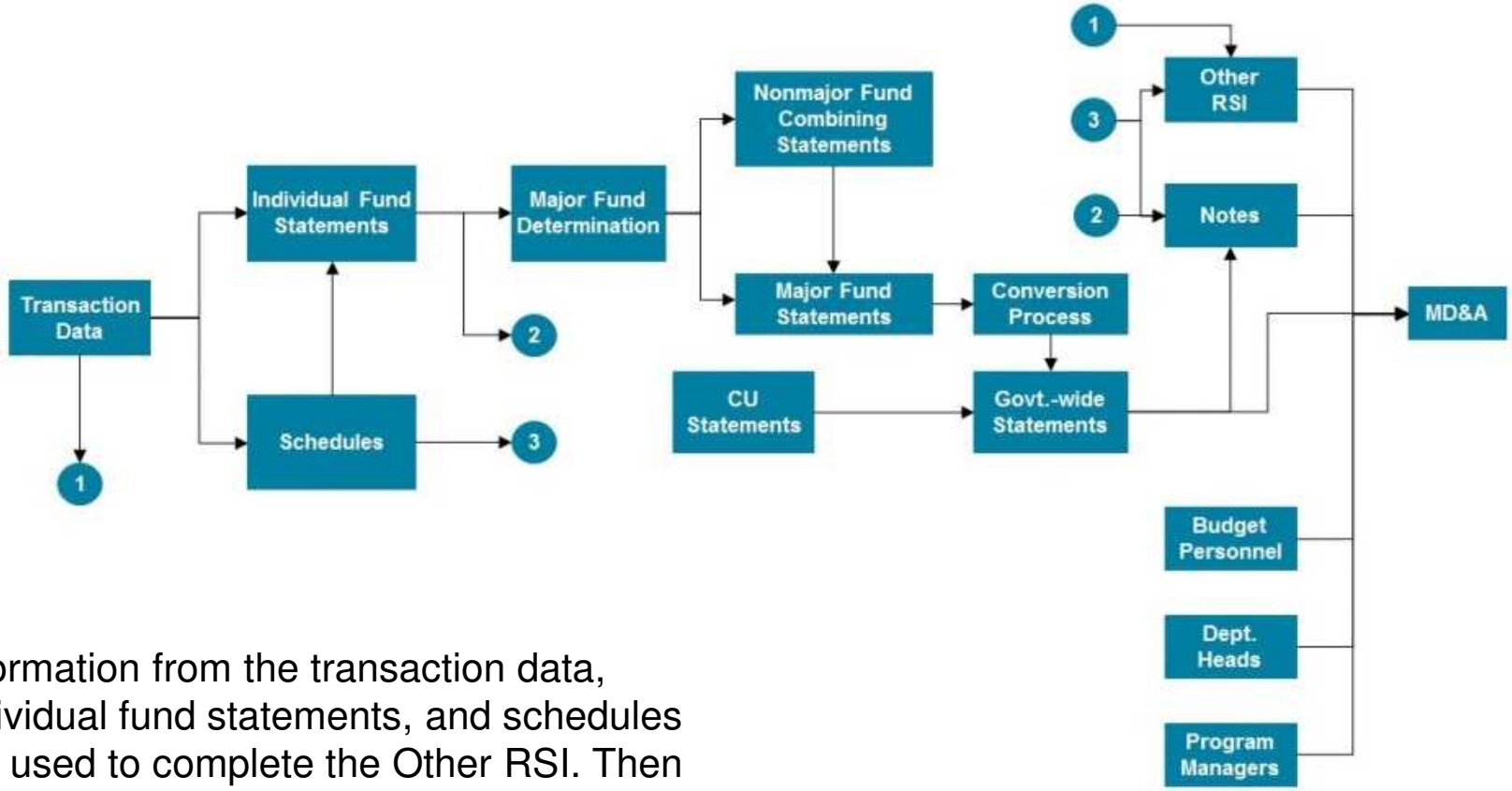
Preparation Process: Step 7



Information from the transaction data, individual fund statements, and schedules are used to complete the Other RSI. Then information from all sources combine to provide data for the MD&A.

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